AWARD OF ATTORNEY'S FEES IN TAX CASES

HEARING

BEFORE THE

SUBCOMMITTEE ON
SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

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AWARD OF ATTORNEY'S FEES IN TAX CASES

THURSDAY, APRIL 25, 1985

House of Representatives,
Committee on Ways and Means,
Subcommittee on Select Revenue Measures,
Washington, DC.

The subcommittee met, pursuant to call, at 10:15 a.m., in room 1100, Longworth House Office Building, Hon. Charles B. Rangel (chairman of the subcommittee) presiding.

Chairman **Rangel**. The Subcommittee on Select Revenue Measures of the Committee on Ways and Means will come to order.

Today, we will consider an expiring provision of the Internal Revenue Code. The code authorizes the award of attorney's fees, in tax cases. The provision was first enacted in the Tax Equity and Fiscal Responsibility Act of 1982. It authorizes the award of up to $25,000 in reasonable litigation costs including attorney's fees in civil proceedings where the taxpayer not only prevails, but also establishes that the position of the United States in the proceeding was unreasonable.

Congress felt that it was appropriate to sunset this provision at the end of this year, so that the Committee on Ways and Means would have an opportunity to review its operation.

The subcommittee is interested in testimony describing the taxpayer's and the tax administrator's experience with this award provision. Specifically, the witnesses should address themselves to these issues: One, the degree to which the taxpayers have been utilizing the provisions; two, the cost of obtaining an award for a taxpayer as well as for the Government in defending against an award; three, the additional time involved in pursuing or defending against an award; four, the effect of the award provision in the tax courts backlog; five, the number and type of cases in which awards have been made; and finally, the size of the awards that have been made.

With this information, the subcommittee should be better able to determine the extent of the award provision.

At this point, I ask unanimous consent to include in the record the subcommittee's press release announcing this hearing.

[The press release announcing the hearing follows:]

[For immediate release, Friday, Apr. 12, 1985]

THE HONORABLE CHARLES B. RANGEL (D., N.Y.), CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A PUBLIC HEARING ON THE AWARD OF ATTORNEY'S FEES IN TAX CASES, THURSDAY, APRIL 25, 1985

The Honorable Charles B. Rangel (D., N.Y.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, announced today a public hearing on the award of attorney's fees in tax cases. The hearing will be held on Thursday, April 25, 1985, at 10:00 a.m. in B-318 Rayburn House Office Building.

Chairman Rangel noted in announcing this hearing that "in light of the expiration of the provision authorizing the award of attorney's fees in tax cases at the end of this year, it is necessary for the Subcommittee to begin to examine the appropriateness of its extension."

Testimony will be heard from the Administration and interested members of the public.

BACKGROUND

Taxpayers who prevail in civil tax actions in which the position of the United States was unreasonable may be awarded reasonable litigation costs (including attorney's fees) up to $25,000 (Code section 7430). This provision, enacted in the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) (TEFRA), is the exclusive provision for awards of attorney's fees in civil tax cases to which it applies. Thus, the Equal Access to Justice Act (P.L. 96-481) does not apply to awards in tax cases.

TEFRA provides for a termination of the award provision for proceedings commenced after December 31, 1985, so that Congress would have the opportunity to review the operations and effect of the provision.

Thus, the Subcommittee is interested in testimony describing taxpayers' and tax administrators' experiences with the award provision, particularly: (1) to what degree taxpayers are utilizing the provision; (2) the costs of obtaining an award for a taxpayer, as well as for the government in defending against an award; (3) the additional time involved in pursuing, or defending against, an award; (4) the effect of the award provision on the Tax Court's backlog; (5) the number of and types of cases in which awards have been made; and (6) the size of the awards made.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225-3627] no later than Friday, April 19, 1985, to be followed by a formal written request to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 100 copies of their prepared statements to the Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearances. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Requests to be heard, prepared statements to be presented in person, and statements filed for the printed record of the hearing, must contain the following information:

1. The name, full address, and capacity in which the witness will appear, as well as a telephone number where the witness or a designated representative may be reached;
2. A list of any clients or persons, or any organization for whom the witness appears; and

3. A topical outline or summary of comments and recommendations.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting written statements for the printed record of the hearing should submit at least six (6) copies by the close of business, Thursday, May 9, 1985, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. (See other requirements enumerated above.) If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Committee office before the hearing begins.

[By subsequent request, the opening statement of Hon. Guy Vander Jagt was submitted for the record:]

OPENING STATEMENT OF THE HONORABLE GUY VANDER JAGT

Thank you Mr. Chairman. The issue the Subcommittee is considering today—the awarding of attorney's fees in tax cases—is one I have been interested in for many years. Indeed, one of the earliest pieces of legislation I introduced in the House of Representatives awarded attorney's fees to any person who litigated with the Federal Government and prevailed.

The legislation this Subcommittee reported out in 1981 (H.R. 4961) allowing attorney's fees to be awarded in tax cases, served as a basis for the provisions that were eventually enacted into law as part of the Tax Equity and Fiscal Responsibility Act of 1982. I will be very interested in seeing how these provisions are being applied in practice, their cost and if they should be made permanent. Of course, I am also interested in the six specific issues raised in the Subcommittee's Press Release announcing these hearings.

Since the current provisions awarding attorney's fees in tax cases are due to expire at the end of this year, the Subcommittee may have to expedite its consideration of this subject. These hearings will allow the Subcommittee to promptly determine if the current provisions can be improved and made more equitable.

Chairman **RANGEL**. I also want to call upon our first witness, an outstanding Member of Congress and certainly of the Ways and Means Committee, to give his observations on this very important matter.

The Chair welcomes the testimony of Congressman Andy Jacobs.

STATEMENT OF HON. ANDY JACOBS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. **JACOBS**. Thank you, Mr. Chairman.

When the committee recommended this legislation to the House and it eventually became the law of the land, it did a very good thing. I think it could have been a better thing, though, and that is what I want to talk about.

As I see it, the problem we addressed has two parts to it. First, if you are a taxpayer and you are hauled into court unreasonably, arbitrarily, or capriciously, you ought to have some recompense for the inconvenience, at least your attorneys' fees ought to be restored to you.

I believe it is up to $25,000 by this statute.

Second, it would serve the interests of the taxpayers, it seems to me, if the same law was a disincentive for the fellow or the woman who did it to you under the color of U.S. Government authority.

The first purpose is served pretty well, it seems to me, by the statute. I am sure the record will be enriched by those who have dealt directly with it.

The second purpose, it seems to me, is served not at all. If a person in the IRS doesn't like you for some reason or another, and just wants to find somebody—I believe Steve Martin's movie "The Sniper," addressed Steve Martin, a stranger, as "you random S.O.B."—if somebody is upset one day and wants to give somebody some trouble, that is not in the best interests of high school civics concepts of our Government.

However, in this circumstance if that person causes trouble, he or she is not the one who makes recompense or makes any sacrifice whatsoever. It is the innocent ones who have to pay for the mistake. And the innocent ones are the taxpayers generally throughout the country.

So I would suggest to the committee that it give some serious consideration, perhaps not the entire $25,000 in the event an award were of that size, but give some serious consideration to provisions by which the human being, not to say the computer—but if there happens to be a human being involved who made the decision, the arbitrary and capricious decision, could be subject to some discipline which is to say participation in the payment of the award—maybe down to the last boat or the last camper in the driveway or something.

In that way you make the real offender smart, as it were. It will be argued that that will discourage officers from doing their duty. As a former police officer, I have heard that many times. But I have always been offended, Mr. Chairman, at the circumstance in which when a police officer is arbitrary and capricious and abusive of a citizen some way or another, brutality or otherwise, where the award is made not against the police officer, but against the taxpayers, who didn't do anything wrong.

You have to steer, it seems to me, Mr. Chairman, between Scylla and Charybdis on this matter. But I don't think you should just stay ashore at Charybdis. I think we ought to find some way to achieve the second purpose, a disincentive without, whatever they say in law these days, chilling, I guess, the inclination for one to do his or her duty in the first place.

It strikes me that an intelligent judiciary can be trusted to determine between and among those cases. There are many malicious prosecution cases brought in this country.

They are not universally successful precisely because of the good judgment of the judiciary making the determination.

That is my recommendation, Mr. Chairman.

Chairman RANGEL. Are you asking that the determination of malicious or wrongful prosecution be considered by the judge in addition to attorneys' fees?

Mr. JACOBS. Of course—well, I suppose it could be prosecution in the case of the initiation of criminal proceedings. But it is in the nature of abuse of process, which I understand is traditionally the term for misuse of the process for civil matters, or, sure, maybe a civil penalty of some sort for the person who brought about the unjust litigation.

When I say unjust, I don't mean inaccurate, but unjust—arbitrary and capricious litigation against the person. To some extent, some of that cost should be assessed against the person who did it rather than against the people who are innocent as the driven snow, just the fellow taxpayers.

Chairman **Rangel**. Are you suggesting that at whatever time the court decides the question of attorneys' fees or whether or not the Government's case was reasonable, that the question as to whether or not there was vindictiveness on the part of the public servant, that

Mr. **Jacobs**. Yes, sir. If it is an arbitrary and capricious act, and the court can find it so—perhaps the finders of fact would be jury—whoever the finders of fact might be, that it was arbitrary and capricious, that it would be statutorily authorized, required, whatever, that some part of the award to the wronged taxpayer be paid by the person who wronged the taxpayer under the color of authority, or under the authority of the U.S. Government.

If I thought I was going to lose my boat, in other words—fortunately, I don't have one, so I am high and dry in that respect—but if I thought I was going to lose my great dane, then I might be a little more careful about being arbitrary and carpricious, and giving you trouble as a taxpayer.

Chairman **Rangel**. That is a unique observation. I would ask the staff to see what remedies, if any, exist on behalf of the taxpayers where clearly the decision to recommend prosecution has been arbitrary, and to see whether or not there is adequate relief in existing law.

Thank you for your contribution.

Mr. **Jacobs**. Thank you, Mr. Chairman. You are doing a great job.

Chairman **Rangel**. We have the Honorable Chief Judge-Elect Sam Sterrett, not only representing himself, but also Chief Judge Howard Dawson. We appreciate the fact that the judiciary recognize how important it is for us to get your understanding, since you people are on the front line. We are very anxious to see whether existing law is working and what recommendations you can make to assure it is fair and equitable.

Your entire statement will be made a part of the record. Each member of the subcommittee and full committee will have a copy of it.

Your Honor, you may proceed as you find it most comfortable.

STATEMENT OF HON. SAMUEL B. STERRETT, CHIEF JUDGE-ELECT, ON BEHALF OF HIMSELF AND HON. HOWARD A. DAWSON, JR., U.S. TAX COURT

Judge **Sterrett**. I appreciate the opportunity of appearing here, Mr. Chairman. I would like to introduce Charles Casazza on my right, the clerk of the court, and Biruta Kelly, an attorney advisor.

I appear on behalf of our estimable Chief Judge Howard Dawson, who could not be here by reason of being out of town. However, effective June 1, I will be taking over as chief judge, a position I look forward to doing, although if Judge Dawson would stop smiling, I would feel better about it.

Anyway, pursuant to your request, with your permission, I will simply highlight what my statement says, and certain aspects which we feel to be of particular importance.

I would like to relate specifically to the experience the court has had with section 7430, which applies to cases as you have stated filed after February 28. Because any eventual legislation in this area would impact upon the effective functioning of the Tax Court, we believe it important to bring the views of the court to the attention of Congress.

And I much appreciate this opportunity to appear and answer questions.

Generally, as I am sure you are aware, pursuant to section 7430, in order for a taxpayer to be awarded reasonable litigation costs, he must establish that he is a prevailing party as defined in that statute, that is that the position of the United States in the civil proceeding was unreasonable and, two, that he has substantially prevailed with respect to the amount in controversy or the most significant issues.

In addition, no decision for litigation cost will be rendered unless the court determines that the taxpayer has exhausted his administrative remedies within the Internal Revenue Service.

You may be interested to know, Mr. Chairman, that the court has rendered four published opinions involving section 7430. The major issue involved in each case was whether the Government's position in the civil proceeding was unreasonable. In addition, approximately 10 to 15 cases involving litigation costs have been closed by settlement of the parties.

The first and most important opinion rendered by our court is that in *Baker* v. *Commissioner,* which was reviewed by the full court—in *Baker,* we held that in order to be entitled to an award of litigation costs, the taxpayer must establish that the Government's position after the petition was filed—and I must emphasize those words—was unreasonable.

We further held that the Comissioners' concession of the case does not automatically mean that his position in a civil proceeding was unreasonable.

In another decision, *Powell* v. *Commissioner,* we denied the taxpayer's motion for litigation costs, because the motion failed to comply with our rules governing the motion—specifically, rule 231B3. The motion in question was defective, because the taxpayer failed first to allege that the Government's position in the action after the filing of the petition was unreasonable, and two, to provide a statement of fact supporting allegations of unreasonableness.

The district courts are divided on the issue of whether to test the reasonableness of the Government's position during the litigation from the time of filing of the petition or from the time the administrative proceeding before the IRS. Several courts have held, as we did in the *Baker* case, that the taxpayer must establish that the Government's position after the petition was filed was unreasonable.

Others have held that the Government's prelitigation conduct must be considered as well in determining the reasonableness of the Government's position.

In all candor, I must say, Mr. Chairman, that the impact of section 7430 on the court's workload has been minimal, and that the court's pending case inventory has not been adversely affected in any measurable way.

One reason is that the Tax Court did not receive the first motions for reasonable litigation costs until mid-1984. Even though section 7430 was made effective for civil actions or proceedings commenced after February 28, 1983, more than 2 years ago.

This time lag occurred because of the fact that the determination with respect to whether a taxpayer is entitled to an award for reasonable litigation costs must be made after the substantive tax issues in the case have been disposed of, either by the court or by settlement of the parties.

The substantive issues and petitions filed after February 28, 1983, would normally not be disposed of before 1984.

Another reason is that in order to recover litigation costs, the taxpayer must first substantially prevail with respect to the amount in controversy, or the most significant issues.

Understandably enough, some taxpayers in Tax Court have not been able to satisfy this initial requirement, and, therefore, have not requested reimbursement of litigation costs.

The litigation costs that have been awarded by the court have occurred in 10 to 15 cases which have been closed by settlement of the parties. The awards made in these cases have been relatively small, generally in the range of $500 to a $1,000 approximately.

By reason of the fact that these awards were made in a settlement context, we of the court have no knowledge of what factors went into making up those figures, $500 to $1,000. The Government, however, has not been able to pay these amounts since no appropriation is currently available to satisfy section 7430 awards made in cases before the Tax Court.

So while complying with the statute, we may in reality be doing a useless act.

The court has not had any indication that the provisions of section 7430 are not operating fairly as far as taxpayers are concerned. Further, I must say in all candor the court's work load has not so far been burdened. To date, our section 7430 experience has been favorable, and we suggest—and we recommend that its expiration date be extended for 2 or 3 years beyond December 31, 1985, in order that we may gain more experience and more insight into handling these issues.

I say, again, Mr. Chairman, that the court appreciates the opportunity the subcommittee has given us to comment on section 7430, and if the subcommittee has any questions, I will be happy to provide you with any further information now or at any other time.

[The prepared statement follows:]

JOINT STATEMENT OF CHIEF JUDGE HOWARD A. DAWSON, JR., AND CHIEF JUDGE-ELECT SAMUEL B. STERRETT, U.S. TAX COURT

I welcome this opportunity to submit the views of the United States Tax Court with respect to section 7430, I.R.C. 1954, which is the exclusive provision for award of litigation costs to taxpayers in civil tax cases. My comments relate specifically to the experience the Court has had with section 7430, which applies to cases filed after February 28, 1983. Because any eventual legislation in this area would impact upon the effective functioning of the Tax Court, I believe it is important to bring the views of the Court to the attention of the Congress, and I appreciate the opportunity to appear and to answer questions.

BACKGROUND

Generally, pursuant to section 7430, in order for a taxpayer to be awarded reasonable litigation costs, he must establish that he is a prevailing party as defined in the statute, that is, (1) that the position of the United States in the civil proceeding was unreasonable and (2) that he has substantially prevailed with respect to the amount in controversy or the most significant issues. Sec. 7430(c)(2)(A). In addition, no decision for litigation costs will be rendered unless the Court determines that the taxpayer has exhausted his administrative remedies within the Internal Revenue Service. Sec. 7430(b)(2).

TAX COURT RULES OF PRACTICE AND PROCEDURE

Rules regarding motions for litigation costs were issued by the court on February 24, 1983. Pursuant to Rule 231(a), a claim for reasonable litigation costs is to be made only after all of the other issues in the case have been either settled by the parties or determined by the Court. The information required to be included in a motion for litigation costs by Rule 231(b) is of critical importance. Generally, the taxpayer must provide clear and concise statements sufficient to show that he meets the statutory requirements for recovery of costs. Under Rule 232(e), the taxpayer has the burden of proving that he has satisfied these requirements. The taxpayer is not required to attach to the motion bills, receipts, or canceled checks verifying the costs. Instead, Rule 231(d) requires that a detailed affidavit documenting the costs accompany the motion.

The procedures for disposing of a motion for litigation costs are provided in Rule 232(a). The Court, in its discretion, may dispose of the motion without a written response by the Government and without a hearing. Alternatively, the Court may order the Government to file a written response. After receiving a written response, the Court may hold a hearing; however, motions for litigation costs generally will be disposed of without a hearing unless there is a bona fide factual dispute that cannot be resolved without a hearing. Discovery of matters that are relevant to the issue of the taxpayer's entitlement to litigation costs may be undertaken when the motion has been noticed for a hearing. Rule 70(a)(2).

OPINIONS RENDERED ON SECTION 7430

The Court has rendered four published opinions involving section 7430. The major issue involved in each case was whether the Government's position in the civil proceeding was unreasonable. In addition, approximately ten to fifteen cases involving litigation costs have been closed by settlement of the parties.

The first and most important opinion is *Baker* v. *Commissioner,* 83 T.C. No. 45 (Nov. 28, 1984), which was reviewed by the full Court. In *Baker,* we held that in order to be entitled to an award of litigation costs, the taxpayer must establish that the Government's position after the petition was filed was unreasonable. We further held that the Commissioner's concession of the case does not automatically mean that this position in the civil proceeding was unreasonable.

Our remaining opinions apply the Baker case. In *Popham* v. *Commssioner,* T.C. Memo. 1984-652, and *Spirtis* v. *Commissioner,* T.C. Memo. 1985-44, we applied Baker to the facts of the particular case and, as in Baker, we found that the taxpayers had not established that the Government's position in the civil proceeding was unreasonable. Hence, we denied the motions for litigation costs.

In *Powell* v. *Commissioner,* T.C. Memo. 1985-27, we denied the taxpayers' motion for litigation costs because the motion failed to comply with our Rules governing such motions, specifically Rule 231(b)(3). The motion in question was defective because the taxpayers failed (1) to allege that the Government's position in the action after the filing of the petition was unreasonable and (2) to provide a statement of facts supporting allegations of unreasonableness.

The district courts are divided on the issue of whether to test the reasonableness of the Government's position during the litigation from the time of the filing of the petition or from the time of the administrative proceeding before the Internal Revenue Service. Several courts have held, as we have in the Baker case, that the taxpayer must establish that the Government's position after the petition was filed was unreasonable. *Brazil* v. *United States,* an unreported case (D. Or. 1984, 54 AFTR 2d 84-5707, 84-2 USTC par. 9596); *Eidson* v. *United States,* an unreported case (N.D. Ala. 1984, 53 AFTR 2d 84-841, 84-1 USTC par. 9182); *Zielinski* v. *United States,* an unreported case (D. Minn. 1984, 54 AFTR 2d 84-5132, 84-1 USTC par. 9514). Others have held that the Government's prelitigation conduct must be considered as well in determining the reasonableness of the Government's position. *Sharpe* v. *United*

States, an unreported case (E.D. Va. 1984, 54 AFTR 2d 84-6480, 84-1 USTC par. 13,574); *Penner* v. *United States*, 584 F. Supp. 1582 (S.D. Fla. 1984); *Hallam* v. *Murphy*, 586 F. Supp. 1 (N.D. Ga. 1983). In addition, the Court of Appeals for the First Circuit had recently taken the latter view in *Kaufman* v. *Egger*, —— F.2d —— (1st Cir. 1985, 55 AFTR 2d 85-1104, 85-1 USTC par. 9278), affg. 584 F. Supp. 872 (D. Me. 1984). The Baker and Powell cases decided by this Court are currently on appeal to the Sixth and Fifth Circuits, respectively. Circuits other than the First, therefore, may soon address this important issue.

IMPACT OF SECTION 7430 ON THE COURT'S INVENTORY

Until now the impact of section 7430 on the Court's workload has been minimal and the Court's pending case inventory has not been adversely affected in any measurable way. One reason is that the Tax Court did not receive the first motions for reasonable litigation costs until mid-1984, even though section 7430 was made effective for civil actions or proceedings commenced after February 28, 1983, approximately two years ago. This time lag occurred because of the fact that the determination as to whether a taxpayer is entitled to an award for reasonable litigation costs must be made after the substantive tax issues in a case have been disposed of either by the Court or by settlement of the parties. The substantive issues in petitions filed after February 28 1983, would normally not be disposed of before 1984 in most cases. Another reason is that, in order to recover litigation costs, a taxpayer must first substantially prevail with respect to the amount in controversy or the most significant issues. Some taxpayers in the Tax Court have not been able to satisfy this initial requirement and, therefore, have not requested reimbursement of litigation costs.

The litigation costs that have been awarded by the Court have occurred in the ten to fifteen cases closed by settlement of the parties. The awards made in those cases have been relatively small, generally in the range of $500 to $1,000, approximately. The Government, however, has not been able to pay these amounts since no appropriation is currently available to satisfy section 7430 awards made in cases before the Tax Court. 63 Comp. Gen. 470 (1984).

CONCLUSION

The Court has not had any indication that the provisions of section 7430 are not operating fairly as far as taxpayers are concerned and the court's workload has not been burdened. To date our experience with section 7430 has been favorable and we suggest and recommended that its expiration date be extended for two or three years beyond December 31, 1985, in order that we may gain more experience and insight in handling these issues.

The Court appreciates the opportunity the Subcommittee has given it to comment on section 7430. If the Subcommittee has any questions, I will be happy to provide you with any further information available to the Court.

Chairman RANGEL. Thank you, Judge.

You can rest assured the committee will rely heavily on your observations. I am totally embarrassed to see that after passing the law, we have not appropriated funds to pay these judgments.

I can assure you that no matter which direction we go, we will be successful this time.

Judge STERRETT. That would be useful, sir.

Chairman RANGEL. Tell me, Judge, do you think that the taxpayer should continue to have the burden to prove that his Government's position was unreasonable?

Judge STERRETT. Yes, I do. I don't see why the Government should be placed in a position that no other person or corporation or individual that initiates litigation has the burden of proof. If I think someone has broken a contract, I sue and I have the burden of proof to prove he has broken the contract. He doesn't have to prove that he did not, initially.

It is just inherent in our Anglo-Saxon common law system.

But it would be a further problem, I believe, if the burden of proof, as is true in Equal Access to Justice Act, is placed upon the

Government—any lawyer worth his salt who has a tax case has got to have an automatic paragraph that comes out of a computer saying we want court costs. It would just be a standard paragraph.

And if the taxpayer otherwise qualified because the Government could not carry its burden of proof, it would then mean we would have to have a second hearing on the extent of the Government's action. It would encourage litigation, and I think be a distortion of the Anglo system of law, sir, to be candid.

Chairman RANGEL. Congressman Jacobs is trying to find some way to avoid arbitrary decisions by Government personnel who bring these cases to court. Can you think of any method that would put some burdens and responsibilities, other than normal disciplinary actions, on those people who make the recommendations whether or not a taxpayer should be hauled into court?

Judge STERRETT. Well, with respect to whether or not—in the context of a Tax Court case, if the petitioner alleges in his petition that the statutory notice which prompted the action is arbitrary and capricious, as we do now and have before these acts, we will listen to the attorney make his argument, make his proffer of proof so to speak, as to what facts he could establish at a trial that would prove the Government was arbitrary and capricious. If the trial judge believes that he has made a prima facie case, he will then hold a hearing on what circumstance arose surrounding the statutory notice.

And if those facts are established that the Commissioner was arbitary and capricious, we will shift the burden of proof in that case. It will be the Government's problem to prove its case in court. There is already that mechanism for it.

If you have reference to Congressman Jacobs' punitive provisions with respect to a Government employee, on that, it seems to me, it goes far beyond IRS, FBI, SEC. I almost hesitate to—that is a tough question.

Obviously if there was such a provision, it would have a chilling effect. And whether or not the circumstances have been developed—and whether there have been so many excesses that it is appropriate to put in such a chilling effect, I don't believe that is a judgment for me to make, sir.

Chairman RANGEL. Have you heard many cases where, after the Government put in its initial case, there was no question in your mind that it was unreasonable?

Judge STERRETT. Obviously after 16 years, obviously some, but not many. I would say a small percentage, a very small percentage. We see—we see no significant problem whatsoever in the unreasonableness of the Government in sending out their statutory notices. It does occur, obviously. But we do not consider that a major problem.

Chairman RANGEL. When you can determine, without any evidence being presented by the defendant or by the taxpayer, that clearly the Government's position is arbitrary and unreasonable, as a prima facie case, do you have a remedy in terms of attorney's fees unless the taxpayer moves to prove the case after the court has already decided it, say in dismissing the case?

Judge STERRETT. Well, yes, we could grant attorney's fees. If the Government's case was arbitrary and capricious, therefore it must have been unreasonable, and therefore everything else would follow. But we can of course award attorney's fees in addition—obviously the taxpayer has prevailed on a substantive tax issue. But we are a court of limited jurisdiction, as you well know, sir, and we have no authority to institute criminal proceedings against the Government lawyer.

Chairman **Rangel**. I am not talking about that. I am talking about the existing statute which requires the taxpayer to carry the burden of proof that the Government was unreasonable. From what you are saying, you are hearing the case in the first instance, and you listen to the Government's case before the taxpayer puts in any defense.

You are saying that under existing law and regulations, you could award attorney's fees.

Judge **Sterrett**. In the normal situation, the taxpayer would put on his case first.

I am sorry if I am being a little obscure, Mr. Chairman, because I am not 100 percent sure I understand your question.

Chairman **Rangel**. I will try again. The Government sues me for tax liability, and they have just made a variety of mistakes of fact. I put in my papers that they have the wrong person or allege someone has made a decision to persecute me.

The Government presents its evidence to you and you agree that there is just no basis, except harassment of the part of the Government, to have brought the case against me in the first place.

You decide, without asking Rangel to come forward, to dismiss the Government's case. I am asking in that instance, do you have the authority to award reasonable fees to my lawyer.

Judge **Sterrett**. No, sir; not at that stage. As you have outlined the facts in your example, where you have come forward—well—as I understand it, you have not testified yet, but your attorney has made allegations that you have been harassed, and maybe he has affidavits, that they are just after Mr. Rangel because they don't like him, for whatever reason—if your attorney made that presentation, we would then ask the Government, demand of the Government to put on witnesses to show that there was some basis for the statutory notice.

If we found that there was no basis for the statutory notice, we would then say to the Government, your statutory notice was arbitrary and capricious, it is your problem now to go forward with the evidence.

Then if the Government was unable to go forward with the evidence, and you prevailed on the merits, your attorney would then file a motion for attorney's fees and he would certainly get them.

I think the thrust of your question—the answers to the thrust of your question is yes; but you just get there a little bit differently than perhaps you said it.

Chairman **Rangel**. Well, I was really trying to see whether I could shift the burden from the taxpayer to the Government.

Judge **Sterrett**. You can, sir.

Chairman **Rangel**. With the assistance of the court.

Judge **Sterrett**. Yes, sir; you can. If you make a proffer of proof that the statutory notice is arbitrary and capricious, and the judge believes that the proffer of proof states a prima facie case, then we will have a hearing on whether or not——

Chairman RANGEL. I would not have to initiate a new action. All of this could be handled at the same time?

Judge STERRETT. Yes, sir.

Chairman RANGEL. Are you satisfied with the $25,000 limit, or do you think there are times——

Judge STERRETT. We have no reason to see where it should be enlarged, sir.

Chairman RANGEL. OK.

Have you thought in your private moments whether there is a need for legislation which will prevent these types of cases coming before the court? I guess that is another way of rewording the Jacobs' solution. Is there anything that could be done, a direction that we could give to IRS, to avoid these unreasonable cases?

Do you believe that the unreasonable cases brought by the Government are normal in terms of civil cases?

Judge STERRETT. No, sir; I do not. I think just like anything else, you read of the horror cases in the paper. I don't think on a numerical or percentage basis, from my personal observation, that it is a major problem.

Chairman RANGEL. Good.

And you say there is no big time involvement in administering and listening to these cases.

Judge STERRETT. Not based upon our current experience. But our current experience is limited.

Chairman RANGEL. It has not adversely affected the backlog of cases in your court.

Judge STERRETT. No, sir; it has not, sir.

Chairman RANGEL. You think it is fair, as it relates to the taxpayer carrying the burden. You don't see any need——

Judge STERRETT. No, sir. As a matter of fact, I would personally strongly oppose a change.

Chairman RANGEL. Judge, you have made this lawmaker's job a lot easier. Let's hope the rest of the people agree with you. Thank you very much for sharing your views with us, and good luck on your new assignment.

Judge STERRETT. Fine. We appreciate the opportunity to appear, sir.

Chairman RANGEL. At this time we will hear from Commissioner Egger. We are always pleased to have you come forward and share your views with us.

You heard the testimony of the good judge. I have taken the liberty to weigh your testimony and to read it. You may proceed as you see fit. I hope you also will take into consideration the questions I asked of the judge.

STATEMENT OF HON. ROSCOE L. EGGER, JR., COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY JIM KEIGHTLEY, ASSOCIATE CHIEF COUNSEL FOR LITIGATION

Commissioner EGGER. Mr. Chairman, I am pleased to be here and to present not only the Internal Revenue Service's views, but also to go beyond that and deal with some of the questions that you have raised.

First, I would like to introduce Jim Keightley. He is the Associate Chief Counsel for Litigation for the Internal Revenue Service. We will both be available to try to deal with questions that I don't cover in this testimony.

We have submitted a written statement. I would like to paraphrase it and try to truncate it a bit in the hope of getting to the number of the issues that you would like to deal with.

Chairman RANGEL. I think that the IRS should be complimented after listening to the testimony given by Judge Sterrett. You may proceed.

Commissioner EGGER. I was pleased to hear it. I must tell you that I was pleased to be present when he made his comments.

I want to say that the administration as well as the Internal Revenue Service does support the extension of the provisions of section 7430, possibly with some clarifying amendments, but in general the thrust of my testimony is in keeping with the position of extension.

I won't spend a lot of time with the preliminaries, Mr. Chairman. You covered them in your opening remarks, and Judge Sterrett has equally dealt with some of them. But it was because of the fact that the Equal Access to Justice Act did not reach the great bulk of tax litigation—because it occurs in the Tax Court and the Tax Court simply wasn't covered in that legislation—that in 1982 the Congress, as a part of the Tax Equity and Fiscal Responsibility Act, enacted section 7430 of the code.

This section awards court costs and certain fees. The section provides for the award of attorney's fees and reasonable litigation expenses in actions brought by or against the U.S. involving the determination, collection, or refund of any tax, interest or penalty in a court of the United States, including the Tax Court.

The new rules of section 7430 apply to litigation begun after February 28, 1983. When Congress enacted section 7430 it did not adopt the definitions in the standards of the Equal Access to Justice Act and apply them to tax cases. Instead, Congress created a new set of definitions and standards intended to apply exclusively to tax cases.

Under these rules, a taxpayer who prevails with regard to the significant issues in the case must show that the Government's position was unreasonable. In addition, section 7430 requires the taxpayer to exhaust the administrative remedies available within the Internal Revenue Service.

As in the case of most other issues in tax litigation, the burden of proof rests with the taxpayer. To try to help in the task of evaluating the reauthorization or extension possibilities, let me briefly recount our experience with this provision.

While in many instances the data we have is limited, it still may be of value in understanding the relative order of magnitude of various aspects of the issue.

Specifically, we know of 60 instances in the Tax Court where the issue of attorney's fees has been raised. Awards were not made in all of these instances. However, we do have some data on what awards have been paid under the Equal Access to Justice Act to date, as well as what awards have been made to date or are in process under section 7430.

Mr. Chairman, we have submitted a tabulation of the cases by category in groups, such as $20,000 and up, $15,000 to $20,000, $10,000 to $15,000 and that kind of thing. It shows that in the case of the Equal Access to Justice Act, with 43 months of experience, some 47 awards have been made, with an arithmetic average of just under $5,000. Under section 7430, with considerably less experience, that is only 26 months, we have about 20 cases where awards have been made. In this instance these awards, on an arithmetic average, tend to be somewhat higher, around $7,000.

As you know, there isn't any dollar cap on an award under the Equal Access statute, but there is a limit of $75 an hour for attorney's time. Under section 7430, there is a statutory cap of $25,000.

As a part of the press release which announced this hearing, the subcommittee asked for information on the cost taxpayers incur in obtaining awards. Unfortunately, only a small number of cases have actually shown the amount of time spent by the attorney litigating a section 7430 issue.

Consequently, we have very limited information on what it costs a taxpayer to obtain an award, or for that matter what it cost the Government to defend against them. We estimate that our attorneys spend somewhere between 10 and 12 hours of extra time on the cases that involve this issue, and we assume that private counsel probably spend at least this amount of time, perhaps a bit more, in view of the necessary burden which they must carry.

However, the fees charged by or the salaries paid to attorneys vary quite widely. As a result, so-called average costs are of questionable value, and we find it very difficult to try to make any calculations that have significance.

The Service's view is that any extension or reauthorization of the attorney's fee provision in tax cases ought to be made by using section 7430 of the Internal Revenue Code as the vehicle. There are a number of basic reasons for this, and I would like to touch on these briefly.

First, section 7430 follows the general rule which is uniform in tax cases, and places the burden of proof on the taxpayer. The burden on the taxpayer is essential to the orderly functioning of the tax litigation process, because the matter before the court is usually a taxpayers' private financial transaction, and only the taxpayer knows or has access to the facts surrounding the transaction.

Thus, in order to flesh out the factual setting, the tax law requires taxpayers to come forward in order to prove their case.

Through this process, then, both the Government and the court learn the essential facts which surround the transaction at issue. Placing the burden of proof on the taxpayer is also important for the stipulation of facts process. In order to clarify the issues at trial, in the typical court case at least, the taxpayer and the Government stipulate as to which factual matters are in agreement and which are in dispute.

As a result, the parties and the courts can conserve valuable time and resources. However, if the burden were shifted, we are concerned that some taxpayers may view it as advantageous to avoid the stipulation of facts process. Some taxpayers may feel that the possibility of an award under section 7430 would be enhanced by keeping the factual setting more uncertain.

Second, we think the unreasonable standard of the section is preferable to the substantially justified standard which is contained in the Equal Access to Justice Act, because the courts are more familiar with it. Also, in light of the highly technical aspects of tax litigation, the term "substantially justified" may be confused with other developing concepts of the tax law such as the concept of substantial authority as is contained in section 6661 of the code.

As a result of these concerns, the standard of unreasonable draws a clearer distinction as to the appropriateness for section 7430 to apply.

Third, the large number of cases that are resolved within the administrative process of the IRS highlights an important distinction between the rules contained in the equal access statute and section 7430. The term "administrative process" refers to the Service's internal mechanism for resolving tax disputes. For example, in fiscal year 1984 we examined something over 1.4 million returns of all types. About 75,000 taxpayers requested assistance from the Appeals Division in settling their cases administratively, that is without going to litigation.

In order to qualify for relief under section 7430, taxpayers are required to avail themselves of administrative remedies.

No such provision is found in the Equal Access Act. The importance of this difference cannot be overstated. Currently about 84 percent of all cases are resolved in the Appeals Division without ever going to the Tax Court. Of those cases that are docketed in the Tax Court, an additional 83 percent are resolved by settlement prior to trial. At a time when the Tax Court's resources are stretched thin over an expanding caseload, the requirement of exhaustion of administrative remedies is essential to the proper functioning of the tax litigation process.

We believe legislation extending section 7430 should make it clear that the "position of the United States" includes only the Government's litigating position. Such a clarification would resolve, at least for the future, any controversy over whether "position" includes underlying agency actions. A significant difference between the Equal Access to Justice Act and section 7430 is that a court's inquiry will be limited to matters that have already been before it, whereas if underling agency action is included, the result would be tantamount to a new trial on new and different issues.

This difference is also important because in a number of cases the Service does not have available all the facts and documentation necessary when it is forced to take a position, because the taxpayer may have been less than forthcoming with the necessary data and documents during the initial administrative proceeding. In fact, at least one court has held that it would be unjust to award attorney's fees where a taxpayer did not provide information to the Service that could have allowed us to correct a problem at the administrative level.

Fifth, a significant difference between the Equal Access to Justice Act and section 7430 is the statutory requirement that the taxpayer must prevail as to the amount or most significant issues in the case. This requirement is well suited to tax litigation, because such actions usually involve a large number of items in controversy. While the taxpayers may prevail on one or more minor items, an award should be made only when the taxpayer prevails in the case in a significant way.

A final area requiring the attention of this committee is the source of funding for the attorney's fees awards. The Comptroller General's decision on July 5, 1984, provides that the permanent judgment appropriation is available to pay awards by the district court or the Claims Court, but not the Tax Court. Additionally, the decision also held that IRS appropriations are not to be used for Tax Court awards. Therefore, while section 7430 authorizes fee awards by the Tax Court, no appropriated funds are available to pay them. We believe the appropriate treatment of this problem would be to amend section 7430 to make the permanent judgment appropriation the source of the awards.

Overall, Mr. Chairman, we see real value in having an attorney fee provision in the law to protect against unwarranted Government actions. Our concern is that this basic safeguard be stated in such a way that neither the individual nor the Government is overly burdened—that the provision is neutral, in other words. We believe that there is a potential for misuse if the attorney's fee issue is allowed to overshadow the underlying substantive issues in tax litigation.

Mr. Chairman, Mr. Keightley or I will be happy to try to answer any further questions that you may have.

[The prepared statement follows:]

STATEMENT OF HON. ROSCOE L. EGGER, JR., COMMISSONER OF INTERNAL REVENUE

Mr. Chairman and members of the subcommittee, I am pleased to be with you today to present the Service's views on the award of attorney's fees and other litigation costs in tax cases. In my testimony, I will briefly review the legislative history of this provision, describe the Service's experience with it, and offer our perspective on future legislative action in this area.

With me today is Jim Keightley, the Associate Chief Counsel for Litigation. Both of us will be available to try and answer any questions you or the other Members may have at the conclusion of my opening statement.

ADMINISTRATION POSITION

Subject to specific conditions, section 7430 of the Internal Revenue Code (the Code) provides for the award of attorney's fees and certain other costs of litigation to a taxpayer who prevails in tax litigation against the United States. Section 7430 is scheduled to expire on December 31, 1985. The Administration supports extension of the provisions of section 7430 with certain clarifying amendments.

EQUAL ACCESS TO JUSTICE ACT

The two principal statutes relating to the award of the costs of litigation are the Equal Access to Justice Act and section 7430 of the Code. While section 7430 is the subject of this hearing, the background of the Equal Access to Justice Act is also relevant to the Committee's deliberations.

Under the general rules of American jurisprudence, attorney's fees are not awarded to the party that prevails in litigation. Recognizing that the expenses of attorney's fees and other litigation costs could unfairly affect persons who litigate against the United States. Congress enacted the Equal Access to Justice Act in 1980. In particular, the Congress was concerned that individuals, businesses, and nonprofit organizations of modest means might be deterred from seeking relief from unreasonable government actions because of the high costs involved.

The Equal Access to Justice Act, Title II of Public Law 96-481. Took effect on October 1, 1981, and applied to cases pending on or filed after that date and prior to

October 1, 1984.[1] It currently applies only to cases pending as of September 30, 1984. The Equal Access to Justice Act provided for an award of attorney's fees to parties who prevail in civil actions brought by or against the United States. Under the Act, a court shall award to the prevailing party certain attorney's fees and other expenses, unless the court finds that the position of the United States was "substantially justified" or that special circumstances make an award unjust. The position of the United States will be "substantially justified" if the United States had a reasonable basis, both in law and in fact, for proceeding in a particular case. The burden of proof is on the United States.

It is important to note that at the time of its effective date, the provisions of the Equal Access to Justice Act applied to actions in courts of the United States as defined in 28 USC 451, but this definition does not include the Tax Court, where the majority of tax cases are heard.

Although Congress passed legislation to make the provisions of the Equal Access to Justice Act permanent, the President vetoed the legislation because it would have extended the definition of the "position of the United States" to include not only the government's position in litigation, but also the position taken in underlying agency actions. Further, the legislation would have required the United States to pay interest on any awards not paid within 60 days of the date of the award, essentially providing more favorable treatment to lawyers who have received such awards than any other group entitled to interest payments from the government.

SECTION 7430

Largely because the Equal Access to Justice Act did not reach the bulk of tax litigation, which occurs in the Tax Court, in 1982 the Congress, as part of the Tax Equity and Fiscal Responsibility Act (TEFRA), P.L. 97-248, enacted section 7430 of the Code, "Awarding of court costs and certain fees".

This section provides for the award of attorney's fees and reasonable litigation expenses [2] in actions brought by or against the United States involving the determination, collection, or refund of any tax, interest, or penalty in a court of the United States, including the Tax Court. The new rules of section 7430 apply to litigation begun after February 28, 1983.

When Congress enacted section 7430 it did not adopt the definitions and standards of the Equal Access to Justice Act and apply them to tax cases. Instead, Congress created a new set of definitions and standards that were intended to apply exclusively to tax cases.

Under the rules of section 7430, a taxpayer who prevails with regard to the significant issues in the case must show that the Government's position was unreasonable. In addition, section 7430 requires the taxpayer to exhaust the administrative remedies available within the Internal Revenue Service. As in the case of most other issues in tax litigation, the burden of proof rests with the taxpayer.

IRS EXPERIENCE WITH THE ATTORNEY'S FEES PROVISION

To help you in the task of evaluating reauthorization or extension possibilities, let me briefly recount the Service's experience with this provision. While in many instances the data we have is limited, it still may be of value in understanding the relative order or magnitude of various aspects of this issue.

Specifically, we know of 60 instances in the Tax Court where the issue of attorney's fees has been raised. Awards were not made in all these instances.[3] However, we do have some data on what awards have been paid under the Equal Access to Justice Act to date, and what awards have been paid to date or are in process under section 7430:

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[1] Other unrelated sections of P.L. 96-481 were effective upon enactment on Oct. 21, 1980. This law also repealed the Civil Rights Attorney Fees Awards Act (42 USC 1988), which had provided for awards of attorney's fees to a prevailing party (other than the United States) in civil actions brought by the United States. This provision had been held to have limited applicability to tax cases because it required the taxpayer to be the defendant.

[2] Reasonable litigation expenses include court costs, expert witness fees, and the cost of studies or analyses necessary for the preparation of the case to the prevailing party (other than the United States).

[3] In addition, there are a large number of cases in the U.S. Tax Court where petitioners have prematurely raised the award issue. However, we do not maintain statistics on this issue.

AWARDS OF ATTORNEY'S FEES IN TAX CASES UNDER EQUAL ACCESS TO JUSTICE ACT AND IRC 7430 (AS OF APR. 15, 1985)

Dollar range [1]	EAJA [2]	IRC 7430 [3] [4]
20,000 and up	1	3
15,000 to 20,000	4	1
10,000 to 15,000	2	2
5,000 to 10,000	9	1
0 to 5,000	31	13
Total awards	47	20
Total dollars	$231,519	$140,734
Average per award	$4,926	$7,037

[1] Under EAJA, there is no dollar cap on an award, but there is a limit of $75 an hour. Under IRC 7430, there is a statutory cap of $25,000 on an award.

[2] 43 months experience applies to litigation pending on or filed prior to Oct. 1, 1984.

[3] Seven awards have not been been paid to date: 4 are still in process and 3 cannot be paid under CG Decision B-210706.

[4] 26 months experience applies to litigation begun after Feb. 28, 1983, and prior to Apr. 15, 1985.

As part of the press release announcing this hearing, the Subcommittee asked for information on the costs taxpayers incur in obtaining awards. Unfortunately, only a small number of cases have actually shown the amount of time spent by the attorney litigating the section 7430 issue. Consequently, we have limited information on what it costs a taxpayer to obtain an award, what it costs the government to defend against them, or what extra time is involved in defending against an award. However, based on the information we have, we estimate that our attorneys spend between 10-12 hours extra on cases involving this issue. We assume that private counsel probably spend at least this amount of time. However, the fees charged by or salaries paid to the attorneys vary widely. As a result, "average costs" are of questionable value and are nearly impossible to calculate.

FUTURE LEGISLATIVE ACTIONS ON ATTORNEY'S FEES

Mr. Chairman, the Service's view is that any extension or reauthorization of the attorney's fees provision in tax cases should be made using section 7430 of the Internal Revenue Code as the vehicle.[4] There are a number of basic reasons for this.

First, Section 7430 follows the general rule found in tax cases and places the burden of proof on the taxpayer. Placing the burden on the taxpayer is essential to the orderly functioning of the tax litigation process because the matter before the court is usually a taxpayer's private financial transaction, and only the taxpayer knows or has access to the facts surrounding the transaction. In order to flesh out the factual setting, the tax law requires taxpayers to come forward and prove their case. Through this process both the government and the courts learn the essential facts surrounding the transaction at issue.

Placing the burden of proof on the taxpayer is also important for the stipulation of facts process. In order to clarify the issues at trial the taxpayer and the government frequently stipulate as to which factual matters are in agreement and which are in dispute. As a result, the parties and the courts can conserve valuable time and resources. However, if the burden of proof were shifted, we are concerned that some taxpayers may view it as advantageous to avoid the stipulation of facts process. Some taxpayers may feel that the probability of an award under section 7430 would be enhanced by keeping the factual setting more uncertain.

Second, we believe the "unreasonable" standard of section 7430 is preferable to the "substantially justified" standard of the Equal Access to Justice Act because the courts are more familiar with it. Also, in light of the highly technical aspects of tax litigation the term "substantially justified" may be confused with other developing concepts of tax law such as the concept of "substantial authority" as contemplated under section 6661 of the Code. As a result of these concerns, the standard of "unreasonable" draws a clearer distinction as to the appropriate cases for section 7430's application.

Third, the large number of cases that are resolved within the administrative process of the IRS highlights an important distinction between the rules of the Equal Access to Justice Act and section 7430. (The term "administrative process" refers to the Service's internal mechanism for resolving tax disputes. In FY 1984, for example, IRS examined over 1.4 million returns of all types; some 75,000 taxpayers requested assistance from the Appeals Division in setting their cases administratively—I.E., without litigation).[5] In order to quality for relief under section 7430, taxpayers are required to avail themselves of available administrative remedies. No such provision is found in the Equal Access to Justice Act. The importance of this difference cannot be overstated. Currently, approximately 84% of all cases are resolved in the Appeals Division without going to Tax Court. Of those cases that are docketed in Tax Court, an additional 83% are resolved prior to trial. At a time when the Tax Court's resources are stretched thin over an expanding caseload, the requirement of exhaustion of administrative remedies is essential to the proper functioning of the tax litigation process.

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[4] Any extension or reauthorization legislation should include the Claims Court, the Tax Court, and the Bankruptcy Court in the definition of "courts of the United States."

Fourth, we believe that legislation extending section 7430 should make it explicitly clear that the "position of the United States" include only the government's litigating position. Such a clarification would resolve, at least for the future, the controversy over whether "position" includes underlying agency actions. A significant reason limiting the issue to the litigating position of the U.S. is that a court's inquiry will be limited to matters that have already been before it. If underlying agency action is included, the result would be tantamount to a new trial on new issues.

This difference is also important because in a number of cases the Service does not have available all the facts and documentation necessary when it is forced to take a position because a taxpayer may have been less than forthcoming with the necessary data and documents during the initial administrative proceedings. In fact, at least one court has held that it would be unjust to award attorney's fees where a taxpayer did not provide information to the Service that could have allowed us to correct a problem at the administrative level.[6]

Fifth, a significant difference between Equal Access to Justice Act and section 7430 is the statutory requirement that the taxpayer must prevail as to the amount or most significant issues in the case. This requirement is well suited to tax litigation because such actions usually involve a large number of items in controversy. While the taxpayers may prevail on a minor item, an award should be made only when the taxpayer prevails in the case in a significant way.

A final area requiring attention is the source of funding for attorney's fees awards. Comptroller General Decision B-210706 of July 5, 1984, provides that the permanent judgment appropriation is available to pay awards by the District Court or the Claims Court, but not the Tax Court. Additionally, the decision held that IRS' appropriations are not to be used for Tax Court awards. Therefore, while section 7430 authorizes fee awards by the Tax Court, no appropriated funds are available to pay them. We believe the appropriate treatment of this problem would be to amend section 7430 to make the permanent judgment appropriation the source of fee awards.

CONCLUSION

Overall, Mr. Chairman, we see real value in having an attorney's fees provision in the law to protect against unwarranted government actions. Our concern is that this basic safeguard be stated in such a way that neither the individual nor the government is overly burdened—that the provision is neutral, in other words. We believe there is a potential for mischief if the attorney's fees issue is allowed to overshadow the underlying substantive issues in a proceeding.

My colleagues and I will be pleased to try and answer any questions you or the other Members may have.

Chairman RANGEL. Thank you, Commissioner. You said you only know of 60 instances where attorney's fees have been raised since the enactment of this legislation?

Commissioner EGGER. Yes, sir.

Chairman RANGEL. Isn't that extremely low?

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[5] Generally, taxpayers who do contest their tax liability with the Service are entitled to deduct the cost of litigating their tax disputes under Code sections 162 or 212. Thus the government is actually sharing the cost of litigating tax disputes.

[6] *Metropolitan National Bank of Farmingtion vs. United States*, 82-1 USTC 9343, E.D. Mich. (1982)

Commissioner **Egger**. I would hope it is not low. Admittedly, we don't have that much experience with it. But I would hope that it would continue about at that level, because it certainly is my obligation to see to it that we do not take unreasonable positions. We want to avoid those wherever possible.

Chairman **Rangel**. Did you state in your testimony how many of these cases——

Commissioner **Egger**. I am sorry, Mr. Chairman, I am not hearing you.

Chairman **Rangel**. In these 60 cases, did you state in your testimony how many of these cases the taxpayer prevailed? Do you know?

Commissioner **Egger**. I am not sure I know. Maybe Mr. Keightley can answer that.

Mr. **Keightley**. I believe Judge Sterrett was indicating the 10 to 15 range as the number of awarded attorney's fees. Sixty is the number of instances in which the issue has been raised.

Also, the point that Chief Judge Sterrett made was that the way the litigation is structured, you raise the section 7430 issue after the substantive issues have been disposed of, so it occurs at the end of the litigation. As a result, the 60 instances were where it was properly raised. When you first file your suit, you cannot say you want attorney's fees; you have to wait until the case is disposed of.

Chairman **Rangel**. In the 60 cases, do you know how many times counsel fees have been awarded?

Mr. **Keightley**. I believe, as Judge Sterrett noted, it is in the 10 to 15 range.

Commissioner **Egger**. We have listed for you in the testimony 20 cases in which awards have been made by the court or where the IRS has volunteered a settlement of that issue.

Chairman **Rangel**. Now, in the cases where the Government lost and the taxpayer prevailed, have you looked into the cause of why the Government's position was unreasonable—where the employee was arbitrary and capricious?

Commissioner **Egger**. I don't think we have any specific information on those. The idea is appealing, though. I think it probably behooves us to do just that.

[The following was subsequently received:]

Review of Award Cases

We have reviewed those cases in which the Service has either settled the litigation cost issue or the courts have made an award under section 7430. The Service does not agree with the cases, such as Kaufman [1] or Hallam,[2] where the courts have held that the "position of the United States", which by law must be "reasonable", is the administrative position of the Internal Revenue Service. Rather, the Service agrees with the decisions in Baker [3] and Brazil,[4] that it is the litigating position of the United States which must be reasonable.

In reviewing these cases, even those with which the Service disagrees as to the propriety of the award, there were no cases in which the courts held that the position adopted by the Service at any level was taken maliciously, harassingly, capriciously, or arbitrarily by an employee of the Internal Revenue Service. There are instances where the position taken by field agents was unreasonable, probably because they did not fully comprehend the application of the law to the facts. This only highlights our need for training and direction to our employees.

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[1] 85-1 U.S.T.C. ¶ 9278 (1st Cir. 1985).

[2] 84-1 U.S.T.C. ¶ 9230 (N.D. Ga. 1983).

[3] 83 T.C. 822 (1984).

[4] 84-2 U.S.T.C. ¶ 9596 (D. Or. 1984).

We are reviewing the need to adopt new procedures in the area of the last known address problem to ensure that cases such as Kaufman are resolved without the need for litigation.

The above situation indicates the need for taxpayers to exhaust their administrative remedies within the Service prior to being eligible to receive an award for litigation costs under section 7430. In several of the cases where the taxpayer did not do so, Counsel received the case and was able to quickly concede the issue. However, this step could be done in our Appeals function prior to any suit being filed or the taxpayer incurring any legal expenses.

Chairman RANGEL. So then you would not have any recommendations as to how to avoid these cases; that is, the unreasonable cases? You have no reason to believe that there was any malicious involvement in any of these cases?

Commissioner EGGER. I know of no instances where anyone can say, and be supported in that statement, that the issues have been carried so far as to get to the Tax Court purely out of maliciousness. I have no doubt but that there are cases where examining officers take positions that turn out to be unreasonable. That is why we support the idea of the award of attorney's fees.

In our training and in our supervision, we do everything we can to see to it that the position taken by the Government is an appropriate and proper position. I believe that the solution to that problem has to lie in training, direction, and in personnel actions in those cases where some individual chooses to take that route; that is to say, to take an arbitrary or capricious position and attempt to control it in that fashion rather than any other way.

I would disagree with the idea that the individual be held to some sort of financial liability, because if we start that, as Judge Sterrett pointed out, that certainly would not be limited to the IRS. However, we ought to be able to take action whenever, in or out of government, somebody takes a position or does something which causes us some difficulty individually.

Chairman RANGEL. You believe that we should make it clear that the position of the United States include only the Government litigation position. I think the staff is bringing to my attention some cases where there has not been proper notice on the taxpayer.

Are you familiar with the *Kaufmann* case?

Mr. KEIGHTLEY. Is that a last known address notice case? There are a number of cases in which the issue of whether we had mailed the statutory notice of deficiency to the last known address has been raised. The code requires us to mail the statutory notice of deficiency to the taxpayer at the last known address; this notice allows the taxpayer to petition the Tax Court. If the notice is not mailed to the taxpayer's last known address, it may be invalid.

The problem you encounter in those cases is trying to figure out whether the taxpayer notified some part of the Service, as to exactly what the last known address is, and whether they gave adequate notice to us to make a correction or a change. We have seen a number of those cases. They are difficult to deal with, just because people are so mobile in this society, and move around. The question is, however, does an agent have to go and verify a last known address when they are dealing with the taxpayer. We will provide more details for the record.

[The following was subsequently received.]

LAST KNOWN ADDRESS CASES

Last known address cases where the government has been required to pay attorney's fees highlight the importance of adhering to the statutory requirement that administrative remedies be exhausted.

Since failure to send the statutory notice of deficiency to the taxpayer's last known address within the statutory period of limitations may invalidate the assessment, the Service makes every effort to avoid errors. A copy of current Internal Revenue Manual instructions detailing the steps necessary to ascertain the taxpayer's address is attached. Despite our efforts, some errors are bound to occur in a large organization that must keep track of millions of highly mobile taxpayers.

For a variety of reasons taxpayers frequently do not notify us when they have moved. In such cases, the taxpayer may not receive the statutory notice and may lose their opportunity to contest the deficiency in Tax Court, even though the notice has been correctly mailed by the Service to the last known address. Regardless of whether the taxpayer has failed to notify us or whether we have made an error, the taxpayer will be understandably concerned when he ultimately discovers that a tax has been assessed.

In such cases, it is vitally important that the taxpayer immediaely contact the Service so that we can stay collection action while we are taking a careful look at the situation and reviewing our files. If we determine that the statutory notice was incorrectly addressed and that the statute of limitations on making the assessment has expired, we will abate the assessment using the authority of I.R.C. § 6404. If the statute of limitations has not expired, we can reopen the taxpayer's case and, if agreement as to the correct liability is not reached, we can issue another, correctly addressed, notice of deficiency. Even if the statutory notice was correctly addressed, if we are convinced that our assessment is excessive or erroneous, it can and will be abated.

In short, these issues can be resolved without litigation.

Like many tax disputes, however, last known address issues, may often be both factually and legally complex and difficult to resolve without contact and input from the taxpayer.

The difficulty here is that many taxpayers are hesitant to contact the Service. Some may be unduly fearful of our collection procedures, some may not be sure of who to contact or how to go about resolving the problem; some may deliberately avoid contact until they are certain that the statute of limitations has expired and the Service is precluded from issuing a new notice of deficiency to the correct address. Whatever the reason, the result is unnecessary litigation.

period for assessment. If an appropriate and timely consent was not filed in any such case, a notice of deficiency will be issued or other necessary steps taken to protect the Government's interests.

(3) In estate tax cases the statutory period cannot be extended by consent; therefore, every effort should be made to complete Examination action within the 18-month cycle (see policy statement P–4–52). In the exceptional case when less than 180 days remain in the statutory period and the taxpayer requests Appeals consideration, the file should be immediately referred to Appeals with a transmittal advising of the early expiration. If, in the opinion of Appeals, there is sufficient time for adequate consideration, the case is accepted. If Appeals believes there is not sufficient time remaining for effective action, the files are returned to the District Director within 10 days for issuance of the notice of deficiency.

(4) A notice of deficiency may be issued before referring a case to Appeals if it is determined that acceptance of a consent will be injurious to the Government's interests because of provisions of IRC 6511(c)(1). Alternatively, district officials may take any other appropriate action to protect the Government's interests before accepting the consent and referring the case to Appeals.

4462 *(8-5-81)*
Mailing of Notices of Deficiency

4462.1 *(10-31-83)*
Manner of Sending

(1) Notices of deficiency will be sent by certified mail to the last known address of the taxpayer, except that when the address of the taxpayer is outside the United States, registered mail will be used. The notice is intended to furnish, to the person liable for the payment of the tax, legal notice that such deficiency exists. It is therefore necessary that notices be issued in compliance with the provisions of the statute. Although the statute authorizes that notices be sent by certified or registered mail, it does not preclude manual or other means of delivery. Any notice of deficiency issued by other than certified or registered mail should be approved by District Counsel prior to issuance.

(2) A notice may be held invalid if it is not addressed to the proper person, or is mailed to the wrong address. Furthermore, if a proper notice of deficiency has not been issued under the express terms of the statute, the assessment or collection of the additional tax may be enjoined by the courts except if the assessment or collection is due to jeopardy or other reasons permitted by the statute.

(3) Be very careful in determining the address to be used. A thorough search of the administrative file should be made to see if the taxpayer has specifically notified the Service to use an address other than the address shown on the latest return being examined. Thus, Forms 872 (Consent to Extend the Time to Assess Tax), Powers of Attorney, and all other file correspondence should be examined to determine the taxpayer's last known address that is not of any temporary duration prior to mailing the notice of deficiency. For example, a notice sent to the last known home address of the taxpayer might be questioned if the most recent power of attorney submitted directs that all originals of correspondence, documents, etc. (not merely copies thereof), relating to the tax matter be sent to the taxpayer in care of the taxpayer's attorney. If the notice will be issued without any contact between the taxpayer and the Service, or if the last contact from the taxpayer disclosed by the administrative file occurred more than 90 days prior to the date the notice will be issued or less than 60 days remain on the statute of limitation, it is imperative that a search be made beyond the administrative file for a last known address. (See IRM 4462.4) If the return being examined includes a Schedule C or Schedule F or is a business return and wages are deducted, check for the address appearing on the most recently filed Form 941 in determining a last known address. Only use the return address in the administrative file if after checking the Master File or AIMS File a different return address is not shown and the statute of limitations is about to expire. If there is any doubt as to what constitutes the last known address of the taxpayer, duplicate original notices of deficiency should be sent by certified mail to each known address.

(4) If duplicate original notices must be sent, statements attached may be legible carbon copies (preferably the first copy) or machine reproduced copies, but the letter parts of the notices must be duplicate originals.

(5) If a notice of deficiency is returned to the District Director because of an incorrect address, it will be remailed to the correct address by certified mail; in such cases, the date of remailing is the effective date of the notice.

4462.2 *(8-5-81)* Records of Mailing

(1) At times questions arise as to the date on which 90-day letters were mailed. The United States Tax Court may not take jurisdiction in any case in which a petition is filed after expiration of the ninetieth day, not counting Saturday, Sunday, or a legal holiday in the District of Columbia, as the ninetieth day. The burden of proof in establishing the date is on the Commissioner. Accordingly, it is necessary that a record be maintained by each District Director showing the dates on which notices of deficiency were sent by certified mail.

(2) It is important that employees in each office, who will be responsible for the recording and sending of certified mail, be fully informed as to the applicable regulations of the postal service.

(3) The record of certified mailing of notices of deficiency should be kept on P.S. Forms 3877 which are supplied in booklet form by the U.S. Postal Service. These books together with a series of certified numbers may be obtained from the local postmaster, provided an average of three or more letters are mailed at one time. In the interest of legibility it is preferable that P.S. Forms 3877 be removed from the book and the information entered thereon be typewritten. The following heading will be typed or imprinted by rubber stamp across the first line of each page of P.S. Form 3877:

"Notices of deficiency, for the years indicated, have been sent to the following taxpayers."

(4) In estate tax cases, the date of death will be used rather than an applicable year.

(5) A rubber stamp, such as shown below, will be used by the designated Service employee to stamp the envelope containing the 90-day letter:

CERTIFIED MAIL
No. ________

(6) The Service employee will then enter the certified number on the envelope, and list the same number together with the name and address of the addressee on P.S. Form 3877. The year(s) for which the notice is applicable, or the date of death in estate tax cases, will be entered in the remarks column opposite the taxpayer's name and address. The notices to be mailed together with P.S. Form(s) will then be presented to the post office. The postal employee first compares the certified mail numbers, and names and addresses, on the envelope with those on P.S. Form 3877 and counts the number of envelopes. He/she then indicates post office receipt of this mail by signing and inserting the post mark on P.S. Form 3877, and returns the forms to the Service employee. The Service employee should initial and date P.S. Form 3877 as part of the permanent record of mailing, in order that, if called as a witness, he/she could testify as to the exact date on which the letters were presented for mailing. The receipted forms will be numbered consecutively and retained in a separate file. Under no circumstances will the receipted P.S. Forms 3877 pertaining to the mailing of notices of deficiency be commingled with any other mailing records. (Disposition of this file is covered by IRM 1(15)59.22, Records Control Schedule 202 for Examination—Regional and District Offices.

4462.3 *(10-31-83)* Notices Returned by the Post Office

(1) If a notice of deficiency forwarded by certified mail cannot be delivered by the U.S. Postal Service because the addressee has moved and left no forwarding address, the District Director will, provided there is sufficient time remaining on the statute, recheck the AIMS file to assure that the notice was sent to the proper address and reissue the notice if a different address is indicated.

(2) In such cases where there is not sufficient time to reissue the notice or where the AIMS file address is the address to which the notice was delivered, upon expiration of the 90-day period, the deficiency will be assessed by default in the absence of a petition to the Tax Court or an agreement. The envelope in which the letter was originally mailed and the notice itself should be securely stapled in the taxpayer's file, as such envelope (and letter) are evidence that the Internal Revenue Service has complied with the law and mailed the notice by certified mail to the taxpayer's last known address.

4462.4 *(10-31-83)* Mailing Notices for Cases Within 60 Days of Statute Expiration

(1) It is very important that the correct address of the taxpayer be secured when a notice of deficiency is being sent for a case where the statute is within 60 days of expiration.

(2) The latest address should be secured by using Form 6882, IDRS/Master File Infor-

Chairman **Rangel**. Do you have any recommendations? Commissioner Egger has made it abundantly clear that one of his missions is to improve the perception that the Tax Code is fair and that the Government is a fair tax collector. When you have these cases where the taxpayers do prevail, do you come up with any recommendations where we can improve this system to avoid these types of things from occurring?

Mr. **Keightley**. I think one of the helpful parts of the current system is that the attorney's fees really highlight areas where the court is saying something has gone wrong with the system.

And I think that is helpful for us, to push it up out of the system. We have an obligation to look at those and see if what was done is something that we agree or disagree with, and who is responsible for it.

So, one of the advantages of the current system is to force those cases forward for us to look at. We regularly look at the last known address question.

Chairman **Rangel**. After you have looked at these complex questions, have you come up with any ideas, any legislative recommendations that can make it easier for you to execute existing law.

Commissioner **Egger**. Mr. Chairman, I would like to make a couple of points in response to that.

No. 1, I know of many, many instances, both in my early life as a practioner and in the position I now occupy, where statutory notices have been issued to taxpayers under circumstances such as a change of address, where the taxpayer simply was not on notice in fact, and where they learned about it and didn't want to incur the cost of going to court. Our Appeals Division has leaned over backwards to try to move quickly and to dispose of the issue if at all possible within that 90 day period, so as to allow the taxpayer to avoid the cost of litigation in those cases.

I have had that experience myself individually, and I have also had it in my present role. We have not recently addressed the issue of whether we should have the statutory authority to abate, or to expunge, or to eliminate a statutory notice—that is, putting it in the discretion of the Commissioner. I am not sure that I should have that authority.

But we would be glad to address that point again and give you our views.

[The following was subsequently received:]

AMENDING IRS' STATUTORY NOTICE RESPONSIBILITIES

The Service has reviewed the issue of whether it should have the authority to withdraw a statutory notice, and has concluded there is no substantial reason to seek this authority. On balance, the confusion caused both to the Service's records and the taxpayer by withdrawing the notice, obtaining extensions of the statute of limitations, and re-issuing amended notices would probably cause more problems than it would solve.

General Counsel Memorandum 39203, dated March 27, 1984, addresses this issue directly. A copy is included here for information and reference.

[Withdrawal of Notice of Deficiency]

PERCY P. WOODARD, JR.,
Assistant Commissioner (Examination).
Attention: Director, Office of IRP, Service Center and Support Programs.

This responds to your November 22, 1983, memorandum (OP: EX: I) in which you request our views on the issue whether erroneous notices of deficiency can or should be withdrawn.

I.R.C. 4461.2 provides, "Once a statutory notice has been issued, it cannot be withdrawn." The Service took this position in *Mitteldorfer Straus, Inc. v. Commissioner,* 39 T.C.M (CCH) 723 (1979). Because it was unnecessary to the case, the Tax Court in Mitteldorfer Straus, Inc. refused to consider whether the Service has the authority to "abandon" or "withdraw" a statutory notice of deficiency. See also *Holter v. Commissioner,* 37 T.C.M. (CCH) 1707 (1979).

In Statutory Notice of Deficiency, G.C.M. 33366, I-2166 (Nov. 3, 1966), we considered the question whether a statutory notice of deficiency may be withdrawn before the taxpayer files a petition with the Tax Court for a redetermination of the deficiency. Our view was that the Commissioner could not unilaterally withdraw a validly issued statutory notice. We thought that such a withdrawal was inconsistent with the statutory scheme for notices of deficiency. For example, withdrawing a statutory notice presupposes that a second statutory notice may be issued. We thought that issuing a second statutory notice was inconsistent with the restrictions on further deficiency letters in I.R.C. § 6212(c).

Section 6212(c) provides generally that the Secretary cannot determine any additional deficiency to that set our in the notice of deficiency mailed to the taxpayer if the taxpayer files a timely petition with the Tax Court. The Commissioner can assert an increased deficiency in pleading with the Tax Court but has the burden of proof. Tax Court Rule 142. Clearly, the Service cannot properly avoid the section 6212(c) restriction on further deficiency letters by withdrawing a first statutory notice and sending another statutory notice in its place.

Withdrawing a valid statutory notice also appears inconsistent with section 6213(a). Section 6213(a) provides that a taxpayer may file a petition with the Tax Court for a redetermination of the deficiency within 90 days of when the notice of deficiency is mailed. Attempting to withdraw a validly issued statutory notice before the taxpayer files a petition with the Tax Court for a redetermination could be seen as an attempt to limit the taxpayer's right under section 6213(a) to petition the Tax Court. We question whether the Tax Court would refuse to consider a timely filed petition for a redetermination on the ground that the valid notice of deficiency was withdrawn, especially if the Commissioner withdrew unilaterally.

In *Mitteldorfer Straus, Inc. v. Commissioner, supra,* the Tax Court, in note 2, referred to *Skaneateles Paper Co. v. Commissioner,* 29 B.T.A. 150 (1933), in which the Commissioner did withdraw a statutory notice. In Skaneateles Paper Co. taxpayer questioned the Board of Tax Appeals jurisdiction on the ground that two statutory notices of deficiency were issued to the taxpayer for the same taxable year. The Board concluded that since the taxpayer did not appeal from the first deficiency notice, the Commissioner was not precluded from sending a second statutory notice, and thus that the Board had jurisdiction to redetermine the deficiency.

Although Skaneateles Paper Co. involves a withdrawn statutory notice, we do not think it provides much reason to believe that the Tax Court would consider favorably the Service's withdrawal of notices of deficency. Also, Skaneateles Paper Co. indicates that the Boards's conclusion would have been different if the taxpayer had appealed to the Board from the first deficiency notice. Since the Service "withdrew" the first deficiency notice in the case before the 60-day appeal period had run, the Board's opinion suggests that the withdrawal would not have been effective if the taxpayer had filed a timely appeal.

We believe if withdrawals of statutory notices are effective only when the taxpayer does not petition for a redetermination, as Skaneateles Paper Co. indicates, that this mitigates against the Service changing its position and beginning to withdraw statutory notices. In G.C.M. 33366, however, we expressly considered only the question of a unilateral withdrawal of a statutory notice by the Service. Arguably, a taxpayer should not be able to petition the Tax Court for a redetermination of a deficiency determined in a statutory notice that both the taxpayer and the Service agree should be disregarded.

On the other hand, whether an agreement between the Service and a taxpayer to withdraw a statutory notice avoids the inconsistency between the section 6212(c) restriction on further deficiency letters and issuing a second statutory notice for the year involved is more doubtful. Certainly in this situation the Service would want the taxpayer to have the burden of proof with respect to the second statutory notice.

The problem is that the Service could be seen by the Tax Court as attempting to avoid the restriction on determining an additional deficiency because this could be a result of the Service's actions. For example, if the Service determined a larger deficiency in the second statutory notice than it had in the first, the Service would have determined an additional deficiency but would want the taxpayer to have the burden of proof for entire deficiency. Even though the taxpayer would have agreed to the withdrawal of the first statutory notice, this is not a procedure provided for in the statutory notice provisions. See sections 6211-6215. It is doubtful that the Service and the taxpayer could agree between themselves that the burden of proof for the additional deficiency is to be different from the way the Code provides. Thus, we believe that the Service would be taking a substantial risk in changing to a policy of allowing agreed withdrawals of notices of deficiency.

In addition, we believe that the legislative history of statutory notices of deficiency supports the current Service position of not withdrawing statutory notices. Prior to the Revenue Act of 1924, a taxpayer's final prepayment appeal of an adverse tax determination was to the committee on Appeals and Review, an office of the Bureau of Internal Revenue. Because this process did not provide for independent review, Congress created the Board of Tax Appeals. See H. Rep. No. 179, 68th Cong., 1st Sess. 7-8 (1924), 1939-1 C.B. (Part 2) 241, 246-7. Congress intended that taxpayers still have full opportunity to administratively resolve alleged deficiencies. Thus, notices of deficiency were contemplated to be issued only after all administrative rights were exhausted. See H. Rep. No. 356, 69th Cong., 1st Sess. 39 (1926), 1939-1 C.B. (Part 2) 361, 368. Since Congress apparently envisioned issuance of notices of deficiency as the Service's final administrative action, further administrative protests or further administrative actions with respect to such statutory notices would be inconsistent with Congressional intent.

In addition, we note that notices of deficiency are intended to be, and normally are, issued only after complete consideration of a case by the Service. We believe that the credibility that therefore attaches to their issuance should not be impaired by providing that taxpayers may attempt to persuade the Service to withdraw notices of deficiency, even though some notices of deficiency may be incorrect. Our view is buttressed by the availability to taxpayers of administrative opportunities to settle issues with the Service during the statutory 90-day period. See IRM 4461.4. We believe, therefore, that there are administrative reasons, as well as strong legal reasons, that support the current Service position of not withdrawing issued notices of deficiency.

You posit the situation in which a taxpayer has mailed to the Service a signed Form 872, Consent to Extend the Time to Assess Income Tax, that was either not received or not associated with the case file by the time a statutory notice was issued, but was subsequently associated and executed by the Service before the general statute of limitations on assessment expired. You ask whether the Service should rely on the 90-day letter and assess the tax at the end of the 90-day period if the taxpayer does not file a petition with the Tax Court? Or, in the alternative, should the Service rely on the consent if the taxpayer does not file a petition in the 90-day period and, instead of promptly assessing the deficiency, return the case to the examining officer for further consideration with the possibility that a second statutory notice would be issued during the period extended by Form 872?

Treas. Reg. § 301.6503(a)-1 provides,

> If a notice of deficiency is mailed to a taxpayer within the period of limitation and the taxpayer does not appeal therefrom to the Tax Court, the notice of deficiency so given does not suspend the running of the period of limitation with respect to any additional deficiency shown to be due in a subsequent deficiency notice.

Thus unless the Form 872 can be relied upon to extend the general statute of limitations in your example, a second statutory notice could not be assessed. Also, Form 872 states, "This agreement ends on the earlier of the above expiration date or the assessment date of an increase in the above tax that reflects the final determination of tax and the final administrative appeals consideration." Thus, if the Service assessed the deficiency determined in the first statutory notice, the Form 872 extension period would apparently end.

We believe that if the Service attempts to rely on the Form 872 as discussed above, taxpayer will likely argue that it gave its consent to extend the statute of limitations in lieu of a statutory notice being issued at that time and that the Service is attempting to avoid Treas. Reg. § 301.6503(a)-1. Therefore, the taxpayer would argue that the Form 872 is not effective to extend the statute as the Service proposes. We have not been able to find any helpful authority on your question. We believe, however, that it would be advisable for the Service to rely on the statutory notice exception to the general statute of limitations on assessment rather than on the Form 872.

JAMES F. MALLOY,
Director.
By: MICHAEL D. FINLEY,
Assistant Chief, Branch No. 3,
Interpretative Division.

Chairman **RANGEL**. Thank you, Commissioner. The record should state the leadership has advised the House that we should expect no votes today. For that reason, many Members here returned to their home district.

Obviously, the bells have rung and I have to go to the floor. I do hope the Commissioner will entertain questions in writing from Members of the subcommittee.

Commissioner **EGGER**. We certainly will be delighted to respond to them. Yes, sir.

Chairman **RANGEL**. Thank you for your contribution. The Chair will recess for 10 minutes. We will resume with the Assistant Attorney General, Glenn Archer, from the Department of Justice.

[Recess.]

Chairman **RANGEL**. We will resume our hearing with the Honorable Glenn Archer, Assistant Attorney General.

We have your testimony. It will be received in full in the record. You may proceed as you see fit. Thank you for appearing.

STATEMENT OF GLENN L. ARCHER, JR., ASSISTANT ATTORNEY GENERAL, TAX DIVISION, DEPARTMENT OF JUSTICE

Mr. **ARCHER**. Thank you, Mr. Chairman. I will try to summarize my testimony to conserve some of your time here.

I am, of course, very pleased to appear before the subcommittee. The attorneys' fees legislation under section 7430 of the Internal Revenue Code will sunset at the end of this year. And it is important that the subcommittee be aware of the experience that we have had at the Department of Justice as well as the experience in the Tax Court.

I will try, therefore, to focus my attention on the tax litigation before the district courts, the Claims Court, and the courts of appeals; and these are the courts in which the Justice Department represents the United States.

The two attorneys' fees statutes of greatest significance in tax cases are the Equal Access to Justice Act and Internal Revenue Code section 7430. EAJA was effective on October 1, 1981, with respect to all cases pending at that time, and it currently applies only to cases pending as of September 30, 1984, as a result of the veto last year of the reauthorization bill for equal access.

The administration, however, supports the reauthorization of equal access, President Reagan's veto was based upon some objectionable substantive amendments that were contained in that bill, and I think equal access will be re-introduced and enacted this year.

The administration likewise supports the reauthorization of section 7430 for tax cases, as has been indicated today by Commissioner Egger, with some clarifying and technical amendments to reflect the experience that we have had.

When equal access was enacted, it authorized fees in tax cases litigated before the article III courts, but it did not apply to the Tax Court. However, during the pendency of the equal access legislation before Congress, the tax writing committees began to study the implications of authorizing attorneys' fee awards in cases brought in the Tax Court.

Concern was expressed that unless the statute was carefully crafted, legislation providing for awards of attorneys' fees in the Tax Court could have serious adverse impact on the backlog of that court.

Another potential problem having significant implications involved the IRS system of administrative appeals which results in the settlements of thousands of cases annually without resort to litigation.

We believe that these two concerns still exist. In the case of the Justice Department the second concern is particularly important—if we did not have the exhaustion provision, section 7430 would have an adverse impact on the administrative settlement of tax cases.

Section 7430, therefore, departs from equal access in several respects, because of these special problems. It, first, places the burden of proof on the taxpayer and the applicable standard is phrased in terms of reasonableness. This approach is tailored to the Tax Court's stipulation process which is the backbone of practice before the Tax Court.

If the burden of proof remains on the taxpayer, and it does for practically every substantive issue in tax cases, taxpayers will have an incentive to work with the Government counsel in an effort to resolve issues pertaining to attorneys' fee awards expeditiously, and with as little court involvement as possible.

One obvious question, I think, is whether there is any significant difference in the outcome as a result of the variations between section 7430 and equal access regarding the applicable standards and the burden of proof.

We have had experience in the Tax Division of the Justice Department with both provisions and it is our view that the results in the cases litigated under section 7430 would likely have been the same under equal access.

So there probably is little, if any, difference between positions that are reasonable and positions that are substantially justified. Indeed, the term "substantial justification" has been defined by reference to reasonableness. The Commissioner in his testimony indicated why the reasonableness standard probably is more pertinent to tax cases than the substantial justification test.

We also feel that the burden of proof generally does not affect the outcome of these cases.

The general focus of the courts, it seems to us in the attorneys' fees cases has been on whether the Government has been guilty of overreaching rather than on the niceties of burden of proof. For these reasons, we support the burden of proof provision in section 7430, where often the records pertaining to taxes and to tax litigation are in the hands of the taxpayers and not available to the Government, and we feel that this burden of proof will help to further the administrative settlement process and to reduce the number of cases that actually get to court.

A second major difference between section 7430 and equal access is that section 7430 requires an exhaustion of administrative remedies. This exhaustion requirement was enacted to ensure that taxpayers would not ignore the opportunities to resolve their disputes administratively.

Again, we support this provision because the administrative settlement of tax issues is highly important, and we should not encourage any more tax litigation than we are presently getting.

A third significant difference involves the standards for eligibility. In enacting section 7430 to cover tax litigation, the Congress believed that the eligibility standards based on net worth as contained in the equal access legislation would result in additional factual disputes that would further burden the courts, and in particular the Tax Court.

Section 7430, therefore, does not limit eligibility by references to the net worth of the taxpayer, but simply puts a cap on the total amount of fees that can be awarded at $25,000. And we certainly support that approach in the legislation.

Section 7430 was effective on March 1, 1983, for cases filed on or after that date. This contrasts with the Equal Access to Justice Act which became effective as to all cases pending on its effective date, whereas section 7430 only applies to new cases filed.

As a result of this, we have only had a small number of cases that have been decided at the trial court level involving section 7430 attorneys' fees, and we have received only two decisions from the courts of appeals to date. One of these involved the narrow issue of whether the denial of an award could be appealed in the light of the prohibition against an appeal in a code section 7429 case—that is a jeopardy assessment case.

The most litigated issue at the lower court level has been the focus on whether reasonableness should take into account the underlying agency position or only the position of the United States in the litigation.

In the one court of appeals case on this issue *Kaufman* v. *Egger,* the court of appeals for the first 2circuit rejected the holding of several district courts and the Tax Court and held that the position of the IRS prior to litigation must be taken into account.

Judge Sterrett indicated that the *Baker* case was the principal case in the Tax Court in which this issue had been discussed. That case is still pending on the taxpayer's appeal.

In most cases, it probably makes no difference whether one considers the conduct of the IRS before the trial or the position defended in court. Looking to the position of the United States in litigation as the basis for determining the reasonableness certainly conserves judicial resources.

The court has merely to look and review the facts and arguments that are made in the case before it, whereas if it had to consider the IRS conduct which was not subject to the trial, it would, in effect, have to conduct another trial on that issue.

Another significant advantage of considering reasonableness in the context of the litigating posture is that it also encourages settlement. Obviously, the Government is more likely to settle cases if it can also settle out the attorneys' fees issue based on the facts made known to it in the case in chief, whereas if it has to develop into what happened before the Internal Revenue Service, that is a much bigger burden on the Government attorneys in determining whether to settle a case.

In our view, the *Kaufman* decision really misread section 7430. The relevant statutory language is that, and I quote, "The position of the United States in the civil proceeding was unreasonable." I would underline "civil proceeding." With that statutory language, it would seem that the position of the United States in the litigation is what Congress intended the courts to consider when section 7430 was originally enacted.

Chairman RANGEL. What would you suggest that the Congress do in cases like the *Kaufman* case?

Mr. ARCHER. The *Kaufman* case is a type of situation which does not happen too often, and it is probably something that should be handled through the administrative process rather than through a litigation and an attorneys' fee contest in court. I think——

Chairman RANGEL. If it is not covered under existing law——

Mr. ARCHER. Mr. Chairman, I cannot hear you.

Chairman RANGEL. If you don't believe they are coming under existing law, and if, in fact, they exhaust their administrative remedies, what protection do you think the Congress should give them. I know that you said we should clarify existing law. I am just asking if we did, how would you suggest that we clarify it?

Mr. ARCHER. I don't know that I have any legislative language that would clarify that Kaufman situation.

Chairman RANGEL. I don't mean legislative language. Do you think they would warrant any additional legislative protection?

Mr. ARCHER. I think that the situation comes up so infrequently. And if the administrative processes are taken care of, are followed by the taxpayer, that this will be likely to happen in only a very few instances. And my real concern is whether we should try to enact legislation giving this type of a right to many, many taxpayers to raise a new issue to solve what may be a relatively small problem that probably could be handled by oversight.

Chairman RANGEL. I am sorry I interrupted your testimony. Go ahead.

Mr. ARCHER. In its press release, the subcommittee asked for information about the cases in which awards have been made under section 7430. In the Justice Department, we have had awards entered in only 14 cases under section 7430. The amounts of these awards have ranged from a low of $540 to a high of $25,000, the maximum.

The total amount awarded is $135,520 or an average of $9,680 per case. The types of cases in which awards have been made include refund suits, bankruptcy cases, proceedings under code section 7429 to review jeopardy assessment, one collection suit, one summons enforcement proceeding, and some suits to enjoin the collection of taxes.

So we have had attorneys' fees awarded in really quite a variety of litigation, but not very many awards overall.

The subcommittee also requested information about the cost to the Government in defending claims for attorneys' fees and the additional time involved. We do not have any information that would really be responsive to that request because we do not isolate our attorneys' timekeeping to specifically identify that work.

In my testimony, I have also called attention to the two technical amendments that we suggest. One relates to the time for filing applications for attorneys' fees and the other deals with a problem that the Government has in collecting awards that are made in its favor by the courts as sanctions, particularly in the frivolous protester type of litigation.

I would hope that the subcommittee would look at these two technical amendments in the process of formulating its legislative language.

I would be pleased to answer any questions that you may have.

[The prepared statement follows:]

STATEMENT OF GLENN L. ARCHER, JR., ASSISTANT ATTORNEY GENERAL, TAX DIVISION, DEPARTMENT OF JUSTICE

I am pleased to appear at the invitation of the Subcommittee to discuss the award of attorneys' fees in tax cases. The operative statutory provision—Section 7430 of the Internal Revenue—is the subject of a December 31, 1985, sunnset provision and it is important that the Subcommittee be made aware of the effect and impact of Section 7430, as well as the interpretative problems currently in litigation. The primary focus of my testimony is on tax litigation before the district courts, the Claims Court and the courts of appeal—the courts in which the Justice Department represents the United States.

Statutes authorizing the award of attorneys' fees in tax cases are a relatively new phenomenon. The two enactments of greatest signifiance are the Equal Access to Justice Act (EAJA) and Internal Revenue Code Section 7430.

The EAJA was enacted in 1980 as the result of a congressional concern that the cost of litigation deters some individuals and small businesses from challenging unreasonable governmental actions. The Congress felt that government accountability would be promoted by authorizing the courts to award attorneys' fees. Similar concerns underlay the enactment of Internal Revenue Code Section 7430 by the Tax Equity and Fiscal Responsibility Act of 1982.

The EAJA was effective on October 1, 1981, and applied to cases pending on or filed after the date. It currently applies only to cases pending as of September 30, 1984. The Administration supports reauthorization of the EAJA and President Reagan's veto last year of legislation reauthorizing the EAJA was based upon objectionable substantive amendments. The Administration likewise supports the reauthorization of Section 7430 with appropriate clarifying and technical amendments.

The EAJA provides for the award of attorneys' fees to a prevailing party against the United States unless the court finds that the position of the United States was substantially justified or that special circumstances would make an award unjust. The burden of proof is on the United States. In order to be eligible for an award, the prevailing party must meet certain net worth requirements. In general, awards of attorneys' fees are limited to $75 per hour. The court has authority to reduce or deny an award because of conduct which unduly and unreasonably protracted the proceeding. An application for an award must be filed no later than 30 days after a final judgment is entered.

While the EAJA authorized attorneys' fee awards in tax cases litigated before the Article III courts, it did not apply to cases brought in the Tax Court. During pendency of the EAJA before the Congress, the tax-writing committees began to study the implications of authorizing attorneys' fee awards in tax cases, particularly cases brought in the Tax Court. Concern was expressed that unless the statute was carefully crafted, legislation providing for the award of attorneys' fees in the Tax Court would have a serious adverse impact on the backlog of the court. Another potential problem having significant implications involved the IRS system of administrative appeals which results in the settlement of thousands of cases annually without resort to litigation.

As a result of these concerns, Section 7430 departs from the EAJA in several respects because of special problems inherent in tax litigation, particularly litigation before the Tax Court. Thus, Section 7430 differs from the Equal Access to Justice Act by placing the burden of proof on the taxpayer and the applicable standard is phrased in terms of reasonableness. This approach is tailored to the Tax Court's stipulation process, which is the backbone of practice before the Tax Court. Indeed, Tax Court Rule 232(b) provides for a conference in 7430 proceedings, the purpose of which is the same as the stipulation conference—to reach an agreement concerning the allegations supporting the claims for attorneys' fees. If the burden of proof remains on the taxpayer, as it does for practically every substantive tax issue, taxpayers will have an incentive to work with government counsel in an effort to resolve issues pertaining to attorney fee awards expeditiously and with as little court involvement as possible.

One obvious question is whether any significant difference in outcome exists as a result of the variations between Section 7430 and the EAJA regarding the applicable standard and the burden of proof. In our view, the results in the cases litigated under Section 7430 would likely have been the same under the EAJA. Little, if any, difference exists between positions that are "reasonable" and positions that are "substantially justified." Indeed, the term "substantial justification" has been defined by reference to reasonableness. Moreover, the burden of proof generally does not affect the outcome in these cases; the placement of the burden of proof on the taxpayer under Section 7430 primarily serves to further the Tax Court's procedures regarding the stipulation of cases. The general focus of the courts has been on whether the government is guilty of overreaching rather than on the niceties of the burden of proof.

A second major difference between Section 7430 and the EAJA is that Section 7430 requires an exhaustion of administrative remedies. The exhaustion requirement was enacted to ensure that taxpayers, in their haste to recover attorneys' fees, would not ignore opportunities to resolve their disputes administratively. Thus, in order to prevent widespread avoidance of administrative settlement procedures, Section 7430 properly requires exhaustion of administrative remedies as a condition precedent for obtaining an attorneys' fee award.

A third significant difference involves standards for eligibility. The Congress believed that eligibility standards based on net worth would result in factual disputes further burdening the courts. Inasmuch as taxpayers of modest means can generally resolve their tax disputes in a relatively inexpensive manner, Section 7430 does not limit eligibility by reference to the net worth of the taxpayer, but simply caps the amount recoverable at $25,000.

Section 7430 was effective on March 1, 1983, for cases filed on or after that date. Only a small number of cases have been decided by the trial courts and we have received only two decisons from the courts of appeals, one of which involved the narrow issue of whether denial of an award could be appealed in light of the prohibition on appeal of actions under Code Section 7429 (relating to review of jeopardy determinations).

The most litigated legal issue is whether the focus of the court in determining "reasonableness' should be on the position taken in litigation or rather on the position taken by the IRS prior to the litigation. In *Kaufmann* v. *Egger*, 85-1 U.S.T.C. para. 9278 (decided Mar. 19, 1985) the Court of Appeals for the First Circuit rejected the holdings of several district courts and the Tax Court and held that the position of the IRS prior to litigation must be taken into account. In most cases, it makes no difference whether one considers the conduct of the IRS before the trial or the position defended in court. However, looking to the position of the United States in litigation as the basis for the determination of reasonableness conserves judicial resources. The court has merely to review the arguments already made in the case before it. If the court were required to consider IRS conduct which was not the subject of the trial or argument before the court, the attorneys' fees proceeding could become essentially another trial.

Another significant advantage of considering "reasonableness" in the context of the litigation posture is that it encourages settlement. Obviously, the government will be more likely to settle a case if it can dispose of the case without having to litigate the merits in an attorneys' fee proceeding. However, if the court must look behind the settlement and consider the conduct of the IRS, essentially the entire case will have to be tried.

In our view, the Kaufmann decision misread Section 7430. The relevant statutory language is that "the position of the United States in the civil proceeding was unreasonable." Section 7430(c)(2)(A)(i). The Congress could hardly have used any clearer language to indicate that the position taken prior to the proceeding is not relevant. The identical issue is pending in other courts of appeal and, in an effort to eliminate unnecessary litigation over this issue, the Subcommittee should consider a legislative clarification.

Another issue that deserves attention is of a more technical nature and involves the time limit in which attorneys' fee applications must be filed. Section 7430(e) provides that an order granting or denying an award of attorneys' fees shall be incorporated in the judgment or decision in the case, thus suggesting that an application is untimely if filed after the 10 days in which a motion to amend a judgment may be filed under Rule 59(e) of the Federal Rules of Civil Procedure. We have taken that position in litigation under section 7430, but have no decisions to date. The difficulty is that the Supreme Court and numerous courts of appeal have held that Rule 59(e) is generally inapplicable to attorneys' fee awards. E.g., *White* v. *New Hampshire Dept. of Employment Security,* 455 U.S.445 (1982); and *FCC* v *League of Women Voters,* 52 U.S.L.W. 5008, 5010-5011, note, 10 (1984).

In Tax Court cases and refund suits, a significant amount of time normally elapses between the date of the court's holding on the merits and the date the judgment is entered in order to make the necessary computations. In other types of cases, such as summons enforcement litigation, bankruptcy cases, and injunction suits, the judgment may be entered at the same time as the case is decided. To clarify the intent and effect of Section 7430 on the timing issue, we recommend that Section 7430 be amended to provide that an attorneys' fee application should be filed in accordance with any applicable court rules, but no later than 30 days following entry of a judgment from which an appeal may be taken as a matter of right.

In its press release, the Subcommittee asked for information about the cases in which awards have been made under Section 7430. Awards have been entered in only 14 cases handled by the Justice Department; and amounts awarded have ranged as low as $540 and as high as $25,000. The total amount awarded is $135,520, an average of $9,680 per case. The types of cases in which awards have been made include refund suits, bankruptcy cases, proceedings under Code Section 7429 to review jeopardy assessments, a collection suit, a summons enforcement proceeding, and suits to enjoin collection of taxes.

The Subcommittee also requested information about the costs of the government in defending claims for attorneys' fees and the additional time entailed. We do not have information responsive to that request because we do not isolate the attorneys' fee segment of litigation as a separate element in our timekeeping system; nor do we otherwise account in a special manner for related costs.

Finally, I would like to bring to the attention of the Subcommittee a somewhat related problem—cases involving the award of attorneys' fees to the government. Within the last two or three years, the courts have become increasingly exasperated over the increasing volume of frivolous suits brought by tax protestors and others who abuse the judicial system. The Congress recognized the seriousness of this problem in the Tax equity and Fiscal Responsibility Act of 1982 by authorizing the Tax Court to impose damages of up to $5,000 against persons who bring frivolous suits. The Tax Court in consonance with the desire of Congress has shown no hesitation in applying this sanction in appropriate cases.

The district courts and the courts of appeals are also aggravated with tax protestor suits, particularly frivolous suits contesting imposition of the frivolous return penalty, and also are regularly imposing sanctions to the point where awards are being made to the government in about five cases a week on average. The system for collecting amounts awarded as sanctions by the district courts and the courts of appeal, however, is much more cumbersome than the system for collecting damages awarded by the Tax Court under Code Section 6673, in that regular judgment collection procedures must be followed. We would like to suggest that the Subcommittee consider an amendment authorizing sanctions imposed by any court in a tax case to be collected in the same manner as a tax, as in the case of damages awarded under Rule 6673.

I will be pleased to respond to any questions that the Subcommittee may have.

Mr. DORGAN. Mr. Archer, the last point you made is one I am interested in. Particularly having had some substantial experience as a tax administrator with tax protesters, I understand the filing of frivolous suits is an attempt to inhibit the process.

What you are saying is that the awards that are made under the TEFRA of up to $5,000 to the Government, which are in the form of penalties to those who file the frivolous suits, are difficult to collect because you are not able to use the system that you normally would use in collecting awards.

Are you proposing specific language to correct that?

Mr. ARCHER. Let me correct that. The $5,000 award can be made in the Tax Court and is collected in the same manner as taxes are collected, so that the IRS, through its administrative collection processes, can collect the Tax Court awards for frivolous or delaying suits.

What I am pointing to is the fact that in a number of district courts and courts of appeals, we are beginning to get awards, under the rules for double costs and in some cases attorneys' fees. These awards are relatively small amounts, and we have no procedure for collecting them other than to go through the normal judgment collection procedures under State law.

Mr. DORGAN. Are you suggesting a procedure for collecting them?

Mr. ARCHER. We are suggesting that the subcommittee should look at this question to determine whether those types of sanctions that are awarded by the district courts and courts of appeal should also be collected in the same manner as taxes, because from the standpoint of resources, it is very difficult to go out and to try to collect them through garnishment and other judgment collection procedures.

Mr. DORGAN. If the district courts and the courts of appeals are beginning to impose those sanctions for frivolous suits that is a hopeful sign. Because what has happened in the last 10 years with the tax protesters in this country is outrageous.

I would like to be helpful in finding a way to fast track the imposition of penalties and sanctions to those involved in those kinds of suits. So if you have some specific suggestions, I would like to be helpful.

Mr. ARCHER. All right. We have just outlined the problem here. We will try to come up with something more specific.

Mr. DORGAN. Thank you.

Chairman RANGEL. Mr. Attorney General, the business community believes that the test of reasonableness is a heavy burden, and "substantially justified" is more equitable as relates to the taxpayer. You disagree with that?

Mr. ARCHER. I disagree with that, yes. In the context of tax cases, as the Commissioner pointed out, the substantial justification language is somewhat confusing, and we would prefer the reasonableness language.

Based on our experience, we don't see that there would have been any substantial difference in the way these cases had been decided had we had the other language.

Essentially, the courts are looking at what is reasonable under the circumstances, it seems to me.

Chairman RANGEL. Thank you very much. The members of the committee will probably have some written questions to forward to you.

Thank you for taking the time.

Mr. ARCHER. Thank you very much, Mr. Chairman.

Chairman RANGEL. Our next witness is Frank S. Swain, Chief Counsel for Advocacy, Small Business Administration.

STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. SWAIN. Good morning, Mr. Chairman. Thank you for the invitation to testify here this morning.

It is my pleasure to appear here today to represent the views of the SBA Office of Advocacy.

I should call the committee's attention at the outset to the fact that these opinions are those of my office, and the views do not necessarily represent the official views of the administration, which, of course, have been ably presented by Attorney General Archer and Commissioner Egger.

I would like to emphasize also, though, that I think in large part our views are substantially similar. We all believe that it is important that there be a fee shifting statute available to the taxpayers in litigation as well as to other types of litigants, and that it is important that fee shifting statute be reauthorized.

There are some differences in degree which I would like to outline very briefly this morning.

I believe that it is important that small businesses and individuals not receive differing treatment by article III courts under the Equal Access to Justice Act compared to the Tax Courts under the TEFRA provision, simply because of the type of litigation that they are involved in.

And I think that maybe instead of reviewing my prepared statement, I would like to try to illustrate the problems that we are encountering or that we see taxpayers encountering with an example that is very similar to the Kaufman case that you have alluded to several times already this morning.

Suppose, Mr. Chairman, you were to decide to move from New York to Mr. Dorgan's State of North Dakota, and you had informed the Internal Revenue Service by all the proper change of address forms that you had moved to North Dakota and commenced to pay your taxes there to the appropriate branch of the IRS office.

In the meantime, the New York IRS office decided they wanted to audit you. They send a notice to your former address in New York. There was no forwarding of it. There was no notice to you of that audit. Assume further that after the IRS received no response from you, they imposed a deficiency upon you as a taxpayer. In the following year, where the IRS owed you some money because of a subsequent refund that was coming to you, they seized that as a deficiency against your previous audit.

Now, I think this case will illustrate the three key points where we differ with the Service and with the Justice Department on the way the law presently is and why we think it ought to be changed.

I think the first and most important point is what is meant by the position of the Government.

You want your money back so you sue the IRS after exhausting their administrative mechanism. Finally, you end up suing them to get your money back.

And the IRS, ably represented by their own counsel or by the Justice Department, comes to court and says to the judge, "we have screwed up, we are sorry, Mr. Rangel properly noticed his move, it is our mistake, we will refund the money."

Now, curiously enough, if you are still living in New York and say to the court: "I am a prevailing party in a tax case against the Government, please pay me x amount of money in attorneys' fees for my efforts", the court in New York would likely say, "We are sorry, Mr. Rangel, but you are not entitled to any attorneys' fees, because even though the IRS messed up, they had a reasonable position in litigation. Once they got into court with you, they realized their mistake, and our duties as judges under the law of the second circuit are to look at only what the Government's position is once they are in court."

The prevailing law in some other places in the country, notably the first circuit now, is to the contrary. Here the IRS' conduct that led them to be in court in the first place is evaluated by the court.

In fact, I think I cannot say it any better than the first circuit did. And I quote from the *Kaufmann* v. *Egger* case.

> It would seem to frustrate the purpose of section 7430 if we were to interpret it in such a way that the IRS, after causing a taxpayer all kinds of bureaucratic grief at the administrative level, could escape attorney's fee liability by merely changing its tune after the initiation of a suit by the taxpayer. This we do not believe is the result envisioned by Congress in granting taxpayers some measure of relief from such situations.

Some courts, as Judge Sterrett said, notably the Tax Court, have said they are going to take a very different, and narrow view, one limited to what the IRS does in court. If the IRS realizes they made a mistake at the time of trial and dropped the case, you cannot get any attorneys' fees, even if it cost you a lot of money to win the case.

This is an issue the Congress needs to clarify. And we would urge they clarify it to the extent that attorneys' fees are available when the agency's prelitigation conduct is unjustified.

Chairman RANGEL. I would agree. How would you define the IRS final action that led to the litigation. Would not this determination become a controversy in itself?

Mr. SWAIN. I think there are ways of defining the term so that the prelitigation position really refers to the last agency position which led to the right to go to court. I am sympathetic to the concerns that have been expressed by the Justice Department that they don't want to open this determination up into a fishing expedition to cover every regulatory decision or every agency memo that might have ever been put in the agency file.

I don't think there is any need to do that. I think there is language that would allow the courts to look at what happened before the actual lawsuit, but with proper limits on discovery.

I might add a side note, Mr. Chairman, that this is exactly the issue, of course, that is in controversy over the reauthorization of the Equal Access to Justice Act. As Mr. Archer stated, there is productive discussion going on now between the Justice Department, and other agency representatives, on how to solve that problem. But clearly the law as written now is inadequate.

The second issue is the burden of proof issue. Let me first say that I have no quibble with the fact that the taxpayer has the burden of proof to show that the IRS was wrong on the merits of the case in chief. But, let's suppose you win your case against the IRS in court.

Once you win your case by proving that the service was wrong, that you, the taxpayer, were right, under the present TEFRA law, you have the additional burden of going forward again and proving that not only were you right on the merits, but the Government was unreasonable in pursuing the case.

Now, the difference between that additional burden and the equal access burden is that in the equal access case, once you win your case, you merely file a pleading and say, "I won my case, the Government was unjustified and now I am applying for attorney's fees." Of course, you still have to prove what the fees have been for, and that the fees are reasonable.

And then if the Government agency feels that it was substantially justified, it has the opportunity to come back into court and argue that there were special circumstances which should deny you the fee award even though you were in the right in the case in chief.

I think that is a very important difference. How is the taxpayer supposed to know, or prove, that the Service was justified besides looking at the four corners of the case that is already in evidence.

Chairman **Rangel**. Wouldn't you agree that the mere fact the Government wasn't able to prove its case in the first instance doesn't necessarily prove that bringing the taxpayer into court was unreasonable? It could very well be that they could not prove the case because the taxpayer really had all of the information that was necessary.

Mr. **Swain**. I would absolutely agree with you, Mr. Chairman. What I am suggesting is that if the taxpayer wins his case, that should be regarded by the court as the prima facie showing that there ought to be a fee award. And then the Service has the opportunity to come in and say we prosecuted this taxpayer because we did not have the evidence that the taxpayer subsequently came to court with—or we prosecuted this taxpayer and in the middle of the case the key witness died or something like that.

In those cases the court is justified in saying that the Service was justified in going ahead even though it didn't win the case.

My point is that the taxpayer focuses on proving the merits of his case in chief, and he has no extra knowledge to suggest that the Service was justified or unjustified. Obviously, if he wins, he thinks, and he has no other reason not to think, that the Service was unjustified in prosecuting it.

Chairman **Rangel**. To put it another way. When the Government loses, there is a presumption that bringing the case was unreasonable.

Mr. **Swain**. Exactly. The presumption should be in favor of the taxpayer. The Government should be allowed the opportunity to get off the attorney's fees hook and say there is something extraordinary about this case, and that even though the Government lost it, it shouldn't have to pay the fees.

That is what happens every day under the Equal Access to Justice Act. To put a double burden of proof on the taxpayer to prove the extra level of unreasonableness after the taxpayer won his case in chief, is unfair.

The third point is on the issue of the current standard of reasonableness versus substantial justification standard. TEFRA says that the Government can avoid paying the fees if it can show that the prosecution was reasonable. The Equal Access to Justice Act says the Government can avoid paying its fees if it shows that its prosecution was substantially justified.

I would submit that there is a difference between those two concepts. They are different legal concepts. There are numerous case decisions distinguishing them.

The reasonableness standard is an easier standard for the Government to meet than the substantially justified standard. I believe that if the Government loses its case, it really ought to meet a high standard of why it lost its case, in order to avoid payment of attorney's fees.

I would suggest that the Equal Access to Justice Act's substantially justified standard be enacted in this law as well. I don't believe that it will add to confusion among the judiciary, nor will there be a burden on the courts or the litigation system.

My litigation experience obviously is somewhat more limited than the previous witnesses, but judges are usually judges because it is their business to distinguish between some of these sticky legal questions and terms.

And I think if properly defined by this committee and the Congress, there will be no confusion.

Chairman RANGEL. Is there any evidence to show that your observations are justified, that the burdens on small businesses are too heavy in these cases?

Mr. SWAIN. I think the evidence is twofold. First of all, the evidence that so few cases under the TEFRA section 7430 have been pursued and won by the taxpayers, in itself gives a demonstration that it is a tough law.

It is no bucket of gold at the end of a rainbow for trial lawyers. It is a tough law. You have to win your case in chief, and then you have to do a lot more.

Second, we can submit to the committee a list of cases that we feel would have been decided differently had different standards and different burdens of proof obtained. The number of decided cases on the TEFRA record is somewhat limited, although there are several hundred under the Equal Access to Justice Act, and we would be happy to submit to the committee a further memorandum on some individual cases where we think the results would have been quite different under TEFRA and under the Equal Access to Justice Act.

Chairman RANGEL. OK; and include in that the additional burden of having to go through the Tax Court before the awarding of attorney's fees.

Mr. SWAIN. Yes, sir.

Chairman RANGEL. We will look forward to receiving them.

Sorry to interrupt.

Mr. SWAIN. In summary, Mr. Chairman, we believe that the record of TEFRA provision section 7430 has shown it has not overburdened the tax system. There has been no potential for mischief, because no mischief has occurred.

It obviously is not a statute that in paying about $167,000 in fees over 3 years, is breaking the budget of either the IRS, the Justice Department, or the Government as a whole.

And there is absolutely no evidence that it is inconveniencing legitimate revenue collection efforts. There is evidence that it is being underutilized by taxpayers, and I think that given that evidence, it is appropriate to suggest to the committee that some changes be made as we have outlined to make it a bit simpler for the taxpayer, having won his case, to apply for and receive fees.

Chairman RANGEL. The record will remain open for you to produce something to show that the fact that the law is being underutilized is because of the reasons that you have stated as opposed to the efficiency of the Internal Revenue Service.

Mr. SWAIN. I appreciate that challenge, Mr. Chairman. We will try to meet it. Of course, it is always difficult to prove a negative.

Chairman RANGEL. I know it is. We just cannot assume that the reason a remedy is not being used is because it is too difficult to meet the standards, even though I would be inclined to agree with you. I don't think that would be sufficient to legislate.

I am very interested in the views of those people which you represent, at least you are this morning. I hope that, rather than just the conclusions, that you will be able to submit more factual information to substantiate the changes that you recommend and the need for the changes.

Mr. SWAIN. We certainly will do our best, Mr. Chairman.

Chairman RANGEL. Thank you.

Mr. SWAIN. Thank you.

[The prepared statement and subsequently received information follow:]

STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Thank you Mr. Chairman. It is a pleasure to appear here today to present the views of the Office of the Chief Counsel for Advocacy on the reauthorization of the TEFRA attorney's fees provision. I would like to emphasize that these opinions are my own and that the views of the administration are represented by the Department of Justice and the Department of the Treasury.

As you may know, the Office of Advocacy has been heavily involved in the reauthorization of the Equal Access to Justice Act, both in the last Congress and in the 99th Congress. I expect a compromise EAJA bill will soon emerge that is acceptable to all interested parties and also serves the purposes of that important small business law. However, I believe it's important that small businesses and individuals not receive disparate treatment, simply because of the type of government litigation they are involved in.

Thus, I believe that it is important that as Congress considers reauthorization of TEFRA attorney's fees provision, it also considers conforming some of the key provisions with that in the EAJA. I believe three changes could be made to TEFRA that would promote this uniformity without burdening government enforcement or litigation strategy. At the same time, I do not believe these changes would result in excessive fee liability to the government.

First, and perhaps the most important, I believe that the government's "position" to be evaluated in the context of a TEFRA fee case should include the IRS final action that led to the litigation. This view was recently adopted by the First Circuit Court of Appeals in *Kaufman v. Egger,* 584 F. Supp. 872 (D. Me. 1984) *affd.* —F.2d— (1st Cir. Mar. 19, 1985). There is a split on this issue. Other courts have concluded that the term "civil proceeding" includes only the litigation arguments made after a suit is initiated. *See, Eidson v. United States,* 84-1 U.S.T.C. para. 9182 (N.D. Ala. 1984); *Sharpe v. United States,* 84-1 U.S.T.C. para. 13,574 (E.D. Va. 1984); *Zielinski* v. *United States,* 84-1 U.S.T.C. para. 9514 (D. Minn. 1984). This latter view is at variance from the EAJA standard adopted by a number of Circuit Courts of Appeal and it has yielded some unjust results. When an arbitrary government action causes a party to have to go to court and the government later admits its error, the private party ought to receive some reimbursement for the legal expense.

Second, I believe the standard for recovery should be based on whether the IRS action was "substantially justified" rather than merely "reasonable". I believe that the "reasonableness" standard too often means that the government must behave vexatiously, or frivolously, before a fee award is made. Congress clearly rejected such a test under the EAJA.

A third, and related point, is that the government should bear the burden of establishing that its position is substantially justified. This is a hallmark of the EAJA, since the government agency is usually in the best position to establish whether its conduct was justified. These last two provisions were part of S. 919, introduced in the 98th Congress, and I believe they are reasonable.

The overall statistical results of the TEFRA experiment have been sketchy. We have been told that there have been less than 20 awards since the provision took effect March 1, 1983. The amounts awarded have ranged from $600 up to the $25,000 fee cap. We believe there are specific instances, however, of results under the current TEFRA provisions that would have been different if the changes I suggest were made.

With respect to the $25,000 fee cap, I have no specific recommendation on whether this provision should be retained. I believe the Committee should carefully analyze the cases to-date, including cases in which fees were denied, to determine if this cap has had an adverse effect on taxpayers who bring complex, sophisticated and thus costly, cases. As you know, the EAJA contains no overall fee cap.

Again, I appreciate the opportunity to appear here today. I look forward to working with the Committee and sharing our experiences under these provisions.

U.S. Small Business Administration,
Washington, DC, May 13, 1985.

Hon. Charles B. Rangel,
Chairman, Subcommittee on Select Revenue Measures, House Committee on Ways and Means, Washington, DC.

Dear Mr. Chairman: This is in response to your request for additional information as a follow up to my testimony before your subcommittee on April 25, 1985. As I made clear in my testimony, these opinions are my own and do not necessarily reflect those of the Administration. The views of the Administration on this issue are presented by the Internal Revenue Service and the Department of Justice.

In my testimony, I proposed three substantive changes in current TEFRA attorney's fee practice: (1) that the government "position" to be evaluated should include the I.R.S. final action that led to the litigation; (2) that the standard for an attorney fee recovery should be based on whether the I.R.S. action was "substantially justified" rather than merely "reasonable" and (3) that the government should bear the burden of establishing that its position is substantially justified.

You asked whether there were specific instances where the results in TEFRA fee cases might have been different, if these proposed changes were the prevailing law. A number of the reported options suggest to us such a result. Some of these cases were commenced before March 1, 1983 and were thus decided under the provisions of the Equal Access to Justice Act (EAJA).

I. THE "POSITION OF THE UNITED STATES" SHOULD BE DEFINED TO INCLUDE THE AGENCY ACTION THAT LED TO THE LITIGATION

A number of the decided cases have turned on this issue. In *Kaufman* v. *Egger*, the court of appeals affirmed the lower court's fee award under section 7430 on the grounds that the government's pre-litigation conduct was unjustified. 584 F. Supp. 872 (D. Me. 1984), *affd*, —F.2d— (1st Cir. March 19, 1985). The case arose because the I.R.S. sent notices of audit and deficiency to the wrong address, even though the I.R.S. files contained the taxpayer's new, and correct, address. At one point, the I.R.S. seized a $606 refund as payment for an earlier deficiency that did not exist. The taxpayer sought injunctive reflief to prevent additional unannounced collection measures. Within two months after the start of the taxpayer's court action, the I.R.S. realized its error and stipulated to the entry of a permanent injunction against any further actions against the taxpayer. The court characterized this case as one arising from "bureaucra[tic] bungling . . . [and] unexplained errors of the I.R.S." Attorney fees under section 7430 were therefore awarded.

Kaufman is important because it is the first court of appeals pronouncement on whether I.R.S. pre-litigation conduct can be evaluated in the context of a TEFRA attorney fee proceeding. Writing for a unanimous panel, Judge Torruella reasoned:

"It would seem to frustrate the purpose of Section 7430 if we were to interpret it in such a way that the I.R.S., after causing a taxpayer all kinds of bureaucratic grief at the administrative level, could escape attorney's fee liability by merely changing its tune after the initiation of a suit by the taxpayer. This we do not believe is the result envisioned by Congress in granting taxpayers some measure of relief from such situations."

Importantly, *Kaufman* might have been decided differently if only the government's litigation position was evaluated in the fee case, since the government stipulated to the entry of a judgment against it. Certainly, it could be argued that this was a reasonable litigation position on the *Kaufman* facts. However, the I.R.S. action that formed the basis for the litigation was, in the court's view, unjustified.[1]

The Kaufman opinion also cites other TEFRA cases that have turned on the "position" question. Illustrative is *Edison* v. *United States,* 84-1 U.S.T.C. Para. 9182, slip op. (N.D. Ala. Jan. 19, 1984). In this tax refund case, the government attorney wrote a letter to the taxpayer-plaintiff's lawyer the day before answering the complaint, advising that the government would consent to a judgment in the full amount of overpaid taxes claimed by the plaintiff. Attorney fees under section 7430 were denied however, because the government "could hardly have taken a more reasonable position." Thus the government avoided having to pay fees over a government administrative action it found indefensible in court.

There have been several other cases where the I.R.S. conceded its error that led to the litigation once in court, but no attorney fees were awarded because of the restrictive view of the "position" term. In *Ashburn* v. *United States,* for example, the Eleventh Circuit reverse an EAJA award of $23,000 made against the I.R.S. after the government conceded in a refund action brought by the taxpayer-plaintiff. 740 F.2d 843 (11th Cir. 1984). In this case, the I.R.S. waited for nearly six months after the taxpayer's suit was filed before sending the administrative file to the Justice Department to defend the suit. Five months later, the DOJ attorneys conceded, before a pretrial conference could be held. While the lower court concluded that the government's litigation position was not substantially justified because the government waited nearly 11 months to concede, the appeals court disagreed: "If the Justice Department had waited years to concede . . . the outcome of the case might be different. But here, the Justice Department waited five months after it received the files before conceding. . . . We hold that this conduct was reasonable." 740 F.2d at 850.

Greenberg v. *United States,* 1 Cl. Ct. 406 (1983) arose on these facts: a taxpayer brought suit in 1980 to recover approximately $4,700 collected by the I.R.S. on the theory that she was responsible for payment of the company's payroll taxes. Because the government was unable to locate the I.R.S. administrative file, the facts had to be reconstructed through discovery. As a result of this discovery, the government agreed that the taxpayer was not in fact the responsible party. Accordingly, in 1982 the government entered into a stipulation of judgment against it for the full amount in dispute plus interest. However, following the restrictive view of the "position" term, the Claims Court concluded: "It does not appear that defendant took an unduly long time to discover the facts or that it put plaintiff to any expense beyond that necessary to satisfy itself of the correctness of her position." 1 Cl. Ct. at 408. EAJA fees of approximately $11,500 were thus denied. *See also, Hill* v. *United States,* 3 Cl. Ct. 428 (1983) (taxpayer prevailed over I.R.S. for full amount sued for plus interest, when government stipulated to entity of judgment against it five months later; litigation position admitting liability was reasonable); *Clark* v. *United States,* 3 Cl. Ct. 194 (1983) (denial of exclusion by I.R.S. caused taxpayers to overpay taxes by $2,100; upon receipt of taxpayer's complaint, the agency concluded that it was in error and stipulated to entry of judgment in the full amount, plus interest; concession called "commendable" and fees denied).[2]

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[1] For another example of a "wrong address" case, this time where the I.R.S. avoided fee liability based on the government's speedy concession of error, *see Alspach* v. *District Director of Internal Revenue,* 527 F. Supp. 225 (D. Md. 1981).

[2] It should be noted that even the leading opinion favoring the "litigation argument only" view of the "position" term suggests that if the government does not immediately accede to the plaintiff's demand, but instead initially opposes his claims and then at some later date surrenders, the government is liable for attorney's fees, both because it acted unreasonably and because it briefly adopted a litigation position lacking substantial justification. *Spencer* v. *N.L.R.B.,* 712 F.2d 539, 555 n.58 (D.C. Cir. 1983). *See also Environmental Defense Fund* v. *Watt,* 722 F.2d 1081, 1086 (2d Cir. 1983) ("We find it incumbent upon the government to abandon its opposition to the other party as soon as it becomes apparent that its litigation stance is not substantially justified").

Ashburn, Alspach, Greenberg, Hill and *Clark* are all examples of I.R.S. cases that may well have been decided differently if a broader view of "position of the United States" were adopted. Some courts are already taking this broader approach. *Britton* v. *United States*, 587 F. Supp. 834 (W.D.Mo. 1984). In this case, the I.R.S. asserted that the plaintiff was responsible for the unpaid withholding taxes of a company which employed the plaintiff as a bookkeeper. The agency refused to investigate the plaintiff's claim and documentary evidence that he was merely a bookkeeper and not the responsible party. Instead, the I.R.S. threatened litigation unless the taxes were paid. The plaintiff paid the disputed amount, retained counsel and commenced a refund action. One year later, after discovery, the I.R.S. settled on terms fully favorable to the plaintiff. In the subsequent EAJA proceeding, the court examined the "agency action which made it necessary to file suit".[3] Finding that the government never had any indication that the plaintiff was a corporate officer, director or other party responsible for the taxes, the court concluded. . . . "The conscious and repeated disregard of this evidence at all levels of government demonstrates the unfairness and unreasonableness of the government's position. . . . [t]his case presents a classic example of bureaucratic indifference and callousness." 587 F. Supp. at 840. EAJA fees were thus awarded.

Britton is a good illustration of how I believe a clarified definition of "position of the government" will work. If section 7430 is to have any meaning, it must be available to redress cases where the taxpayer is forced into court, through no fault of his own, and the taxpayer prevails.

II. THE STANDARD OF IRS CONDUCT IN TEFRA CASES SHOULD BE "SUBSTANTIAL JUSTIFICATION"

Section 7430 allows taxpayers who prevail in civil tax litigation to recover attorney's fees if they can establish that the government's position in the litigation was "unreasonable." The EAJA, which applies to all other civil litigation against the federal government, requires a fee award to a prevailing party unless the government can prove that its position was "substantially justified."

When considering the reasonableness standard incorporated in TEFRA, the Ways and Means Committee expressed concern over the Tax Court's caseload, and the possibility that a "permissive" standard like that found in the EAJA would reduce the incentive to settle and would, in fact, promote litigation on the part of taxpayers hoping to win attorney's fees. H.R. Rep. No. 97-404 at 11 (1981). It was also argued that a substantial justification standard would be too costly, since more awards against the government would be made and that the burden on government attorneys would result in less vigorous enforcement of the laws.

Aside from the Tax Court's backlog of cases (which the TEFRA fees provision is not responsible for, according to Judge Sterrett's April 25 testimony, p. 13) these concerns have been largely unrealized. After three years of the EAJA experience, there has been no indication that private parties are less willing to settle cases. Indeed, as another withess pointed out to the Committee in his testimony, small businesses always have an incentive to settle litigation quickly.[4] As for cost, the actual cost of the EAJA (and its substantial justification standard) has been approximately one percent of the Congressional Budget Office's 1980 estimate of $100 million per year. Having a higher standard applied to the I.R.S. would have only a marginal effect on total EAJA costs, since the CBO estimated that only a relatively small percentage of government litigation involves tax cases. There has also been no evidence to indicate that government lawyers have been intimidated by the costs or effort of showing substantial justification. The government has never testified that substantial justification is too hard a standard to live up to. Rather, I would hope that government lawyers are not bringing unjustified cases precisely the point of the law.

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[3] In addition to closely tracking my proposed definition of the "position" term, this language is also very similar to that recently proposed in the bill to reauthorize the EAJA (H.,R. 2223): " 'Position of the United States' means, in addition to the position taken by the United States in the civil action, the action or failure to act by the agency upon which the civil action is based. . . ." H.R. 2223 enjoys bipartisan support in the Congress and is also supported by the Administration. I can see no reason to have two different standards—one in tax cases and one for all others—by which to measure government agency conduct.

[4] *Award of Attorney's Fees In Tax Cases: Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means.* April 25, 1985 (testimony of James H. Lagos, p. 82-3), ("When the small business person gets involved in any type of administrative proceeding or any type of court proceeding, that person who is the key person of business is away from the business. So the fact that you are paying for his attorney's fees doesn't really make that person whole any how. He or she is still out, because they have to take time away from their business. Small business will avoid litigation like the plague, and continue to settle cases any way they can . . .")

It has been suggested that there is no practical difference between these two standards of government conduct, because many courts have interpreted the EAJA standard to mean "reasonable" anyway. There is also support for this view in the EAJA's legislative history ("Where the government can show that its case had a reasonable basis both in the law and fact, no award will be made". H.R. Rep. No. 96-1418 at 11 (1980)).

However, a growing number of courts have reasoned that the applicable standard for substantial justification is *slightly above* one based on reasonableness, in that the Senate Judiciary Committee, following consideration of the matter, refused to adopt an amendment to the original EAJA changing the language from "substantially justified" to "reasonably justified".[5]

For a further discussion of Congressional intent on the distinction between these two terms, *see* S. Rep. No. 98-586 at 11-12 (1984) and H.R. Rep. No. 98-992 at 7 (1984), the committee reports that accompanied S. 919 and H.R. 5459 (EAJA reauthorization legislation in the 98th Congress).

Admittedly, it is sometimes difficult to distinguish, by definition, between the two terms in any meaningful way, without a unique factual context as a background for a decision. A recent TEFRA case point out the problems with the present "reasonableness" standard. In *Walsh* v. *United States,* No. 4-84-692, slip op. (D. Minn. Jan. 4, 1985), the taxpayer won a $325 refund action, when he was able to prove that he did not sign or tacitly consent to his former spouse signing his name to a joint return. The court held that the taxpayer was entitled to file separately, as was his intent. The taxpayer won the case by summary judgment; the court concluded as a matter of law that the government's case was insufficient. The government's use of the tacit consent rule and legal precedent was found clearly inappropriate on these facts. Yet the application of section 7430 resulted in a denial of a fee award. The court found that the position taken by the I.R.S. in the litigation had a "reasonable and good faith basis," though it was clearly wrong. I believe this was an unjust result, occasioned by a too lenient standard applied to government conduct. As the legislative history of the EAJA states:

"Certain types of case dispositions may indicate that the government action was not substantially justified. A court should look closely at cases, for example, where there has been a judgment on the pleadings or where there is a directed verdict. . . . Such cases clearly raise the posssibility that the Government was unreasonable in pursuing the litigation. H.R. Rep. No. 96-1418 at 11 (1980))."

Walsh points out the problems with subjecting the government's actions to merely a "good faith" or "reasonableness" test, instead of substantial justification: private parties simply will not recover fees.

As in the case of the "position of the United States" issue, there is no principled reason to promote conflicting terminology or standards of agency conduct, simply because of the type of litigation (tax or all other) underlying the fee petition. There can be no argument that the I.R.S. should be as justified in its conduct as all other federal agencies. Thus, I suggest the Committee take this opportunity to resolve any ambiguity in this area.

III. THE BURDEN OF PROVIDING SUBSTANTIAL JUSTIFICATION SHOULD BE ON THE GOVERNMENT

The prevailing rule in TEFRA attorney fee cases is that the initial burden of proof is on the taxpayer to submit evidence that the position of government was unreasonable. The Conference Committee report on TEFRA explicitly makes this clear and contrasts it with the burden of proof provisions found in the EAJA. S. Rep. No. 97-530 at 687 (1982). The EAJA allocated the burden to the government because it is far easier for the government, which has control of the evidence, to prove its actions justified than it is for a private party to marshal the facts necessary to prove otherwise. H.R. Rep. No. 96-1418 at 10, 11 (1980).

I urge the Committee to adopt an amendment that would shift the initial burden of proof to the government to present evidence that its position was substantially justified. These changes in the initial burden of proof should be limited solely to the question of the substantial justification of the government's position on the substantive tax issue involved in determining tax liability. This change would in no way relieve the taxpayer of the burden of proving that he has substantially prevailed, exhausted administrative remedies, and that the amount of the fee claim is reasonable. This shift in the initial burden is limited to only the determination of whether or not the government's position on substantive tax issues was substantially justified. This approach recognizes the distinction between the case-in-chief and the subsequent fee case by a substantially prevailing taxpayer.

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[5] *Spencer v. N.L.R.B.*, 712 F. 2d 539, 558 (D.C. Cir. 1983); *Natural Resources Defense Council, Inc. v. EPA*, 703 F.2d 700, 721 n.7 (3d Cir. 1983), Hunter, J. (concurring and dissenting opinion); *Wolverton v. Schweiker*, 533 F. Supp. 420, 424 (D. Idaho 1982), *reversed on other grounds and remanded*, 726 F.2d 580 (9th Cir. 1984); *Nunes-Correia v. Haig*. 543 F. Supp 812, 817 (D.D.C. 1982); *Ulrich v. Schweiker*. 548 F. Supp. 63, 65 (D. Idaho 1982); *see also*, S. Rep. No. 96-253 at 8 (1979).

I agree that, in the usual case, the taxpayer is in the best position to know the facts relevant to the merits case. However, I can see nothing paricularly unique about attorney fee litigation in tax cases that warrants a departure from the EAJA approach.

The instances of "wrong address deficiency notices" may help illustrate why it is sensible to shift the initial burden. The taxpayer in these cases has no way to know why the I.R.S. sent the statutory notice to the wrong address.[6] The taxpayer is simply not in the best position to know the facts. The less the taxpayer knows about how the decision he is challenging is made, the less effective he will be in proving it wrong or unreasonable. This is, of course, usually the critical factor in deciding which party should bear the burden of proof on an issue.

If the I.R.S. can justify its error, it will not be liable for fees. For example, in a situation where the taxpayer withheld information from the I.R.S. that ultimately resulted in litigation (such as not filing a proper change of address), the government may easily prove substantial justification. However, when I.R.S. errors remain unexplained and uncorrected throughout the exhaustion process, and the party must seek, and win, court relief, a procedural rule should not dictate the fee result.

Finally, there has been no evidence that placing the burden of proving substantial justification of the government in EAJA cases has caused problems for government litigators. Neither has the government complained about this burden as a matter of policy in the contest of EAJA legislation, Thus, I urge the Committee to conform the burden of proof in tax cases to that found in the EAJA. To do so will benefit the taxpayer without inconvenience to the government.

Yours very truly,

FRANK S. SWAIN,
Chief Counsel for Advocacy.

Chairman RANGEL. Prof. Louise Hill, University of Toledo College of Law. What is the difference between a college of law and a school of law?

STATEMENT OF LOUISE L. HILL, ASSISTANT PROFESSOR OF LAW, UNIVERSITY OF TOLEDO COLLEGE OF LAW

Ms. HILL. Very little, Your Honor.

Mr. Chairman, as you noted, I am on the faculty of the University of the Toledo College of Law. Up until September of 1983 I was with the Justice Department in the capacity of Assistant U.S. Attorney in the northern district of Ohio. So in terms of my perspective to this matter of fee legislation, I am approaching it from the viewpoint of an academician, as well as an attorney who practiced under this kind of fee award legislation.

I would ask that my statement be included as part of the record. And I would also suggest that rather than reading my statement, I briefly outline some of the major points.

Chairman RANGEL. Without objection.

Ms. HILL. Thank you, sir.

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[6] Illustrative of typical proof problems faced by the taxpayer is a former Court of Claims case attempting to define "harassment" by the I.R.S. *Sarkes-Tarzian, Inc. v. United States*, 412 F.2d 1203 (Cl. Ct. 1969). The court stated that a prerequisite to determining the existence of harassment was "knowledge as to why the I.R.S. handled the taxpayer as it did." *Id.* at 1215 (Nichols, J. concurring). The court did not delve deeply into the difficulty or obtaining such knowledge.

There are certain fundamental differences that have been noted during the proceedings today between TEFRA, which, of course, deals with tax cases and fee awards, and other legislation that deals with general civil litigation, mainly the Equal Access to Justice Act, which was promulgated in 1980.

Directing our attention to those differences in TEFRA there is a maximum ceiling of $25,000, in the Equal Access to Justice Act we don't see a ceiling, but instead we see an hourly minimum placed on attorneys' fees of $75 and we also see eligibility requirements, net worth, and size limitations.

As far as prevailing party status is concerned, under TEFRA, as has been noted, the taxpayer must prove the Government's position was unreasonable and that he substantially prevailed with respect to the amount in controversy, or with respect to the most significant issue or set of issues.

Under the Equal Access to Justice Act, the prevailing party has been interpreted to be a party who succeeds on any significant issue in litigation which achieves some of the benefits the lawsuit sought. That standard, adopted from a first circuit case, has been reiterated by the Supreme Court in *Hensley* v. *Eckerhart,* which focused on civil rights attorneys' fees litigation. That fact notwithstanding the courts in interpreting the Equal Access to Justice Act have relied on the Hensley standard for prevailing party determinations. The fee liability under EAJA is avoided, though, if the U.S. position was substantially justified, and substantial justification in the act's legislative history indicates we are talking about a standard of reasonableness. While TEFRA addresses unreasonable Government conduct and the EAJA focuses on the reasonableness of the Government's position, the primary difference is the burden is on the United States under the Equal Access to Justice Act, and is on the taxpayer under TEFRA.

If I might note for a moment the proposed amendments to the Equal Access to Justice Act from 1984, which were passed by Congress, as has been noted, but were vetoed by President Reagan in November 1984.

Congress, under the proposed 1984 amendments to the Equal Access to Justice Act, upped the fee net worth limitations set therein to $2 million for individuals and $7 million for business, from $1 million and $5 million respectively. The prepared amendments also defined the position of the United States, which had been a matter of dispute among the various courts, as an action or omission by the Government which led to the underlying action or civil lawsuit.

During the discussion on the amendments to the Equal Access to Justice Act, at one point the Senate draft of the amendments submitted to the House included provisions which would have amended the fee provision of TEFRA. It was suggested that the maximum be raised to $50,000 and that the taxpayers' burden of showing Government unreasonableness be eliminated in favor of having the Service show that its administrative actions which gave rise to the issues in the proceeding were substantially justified in order to avoid fee liability. Also to be included was language regarding a showing of special circumstance to avoid fee liability, to make TEFRA more consistent with the Equal Access to Justice Act.

This proposed language was opposed by the House, however, and was deleted from the draft of the amendments which were finally approved by Congress, though, as I noted, vetoed by the President.

If you look at the reasons that have been given for a distinction between how attorney's fees in tax cases should be treated versus how fees in general civil litigation should be treated, supposed peculiar problems in tax cases are noted that make tax cases distinct from general civil litigation.

One of the things that has been noted in arguing for a distinction is the heavy case load of the Tax Court. I would suggest, however, that all of the Federal Courts have heavy case loads. And, from the testimony which I have heard this morning, it doesn't appear that the Tax Courts are being terribly adversely affected by the TEFRA fee award legislation.

Another distinction is the fear that court fee awards would discourage taxpayers from using informal special tax court small case procedures, and also would discourage settlements in the Internal Revenue Service regional offices. Regarding this argument, I would say the same could be said for general civil litigation, in that court fee awards could discourage settlements at all of the initial stages of litigation as well as in proceedings at the administrative level.

Another reason given by the Government for why tax cases are distinct from civil litigation is that since tax cases often involve many unrelated issues of fact and several taxable years, often tax cases have no clear cut winner. I would simply note that there are many multi-issue civil cases, and seldom do we see one party prevail on all of the issues raised in a general civil case.

Another point that has been raised in arguing for a distinction is that when we talk about partly net worth and size restraints, such restraints don't serve the same purpose in a tax case as they would in other civil litigation. The Government asserts that such restraints are unnecessary in tax cases since complex and sophisticated issues which are costly to litigate are usually raised by wealthy individuals or corporations.

There also has been an assertion by the Government that asset size is difficult to determine in a tax case. I would simply say that what we seem to be dealing with here is not a rationale for a distinction, but rather a justification for a difference between the awards and for limiting fee awards.

Some other things were raised this morning relating to the distinction between tax cases and civil cases with respect to the burden of proof. The Government, in putting the burden of showing unreasonableness on the taxpayer, is relying on the fact that only the taxpayer knows or has access to facts surrounding the transaction of his private financial transactions.

But I would add that only the Government knows the reason that their position was taken. The Government asserts the position that the burden of proof must be on the taxpayer, from the standpoint of encouraging stipulations of fact during Tax Court litigation in that if it were otherwise it might discourage stipulations of fact. I would say that this, again, could be applicable to all civil cases. Furthermore, we consider the fee issue in a tax case after the substantive issues have been decided, a fact which Commissioner Egger's colleague referred to, and so the possibility of discouraging stipulations of fact is not a problem.

As far as which position of the Government would be applicable, the Government suggests that we use only the litigation position in that this would then limit the evidence to be considered by the court to matters it has already heard, and it would take up less time.

I would simply say that we have to look to the purpose of this legislation. What we would be saying if we limited the Government's position to its litigation position is, no matter what the conduct of revenue officers or agents initially, there is no fee liability if the minute we get to court we have counsel for the Government taking a reasonable position.

What I would do, Mr. Chairman, is perhaps suggest that we arrive upon some kind of an exhaustion remedy, when we talk about what Government position we should focus on—the litigation position or the prelitigation position. If someone brings a claim and a taxpayer feels that the Government's position is unreasonable, so as not to burden all of the taxpayers of this country, at that moment we would say that the taxpayer involved in the lawsuit would have an obligation to bring this purported unreasonable conduct to the attention of a designated person with the agency. This would give that designated person in the agency an opportunity to correct the purported unreasonable action of the Government official, and at that point, once the agency has had an opportunity to correct the position by someone in authority, we would click in the determination of reasonableness, with respect to evaluating the position of the Government.

That way the taxpayers in general would not be burdened by a mistake by a low-level Government employee, but we would have someone—and I feel, sir, I can say that, having been a Government employee for many years—we would have someone in a responsible position being the one to make the determination to what the Government's substantive position should be.

If we have a situation where the tax case matters are distinctive enough to warrant separate legislation, then separate legislation is appropriate. However, what I don't feel is appropriate is lacing that separate legislation with standards that are more stringent than those which apply to civil litigation in general involving the Federal Government.

I would suggest that the committee determine what threshold qualifications are necessary for a party to be eligible for a fee award from the Federal Government, and to apply those standards uniformly to all parties involved in lawsuits with the Federal Government.

I see nothing wrong with having an exhaustion of administrative remedies requirement, or of excluding declaratory judgments as matters that would be eligible for fee awards in tax cases.

But I would say, sir, that the underlying standards for fee recovery should be applicable to any citizen that is involved in any litigation with the Federal Government.

[The prepared statement follows:]

STATEMENT OF LOUISE L. HILL, ASSISTANT PROFESSOR OF LAW, UNIVERSITY OF TOLEDO COLLEGE OF LAW

SUMMARY

The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 contains provisions for the award of costs and fees to successful litigants in civil tax cases. The cost and fee provisions of TEFRA, however, are more stringent than are the attorneys' fees provisions of the Equal Access to Justice Act (EAJA), which enable qualifying parties to recover fee and cost awards in other civil litigation involving the federal government. It is the position of the Department of the Treasury that due to problems peculiar to tax cases, tax litigation requires specifically tailored legislation for cost and fee awards which is separate and distinct from fee legislation for civil litigation in general. A review of the rationale presented by the Department of the Treasury in support of its claim that distinct fee legislation is necessary in tax cases, however, reveals a purported rationale which is equally applicable to all civil litigation. It may well be that fee awards in tax cases are best dealt with separately from other civil litigation in light of certain procedural and administrative considerations; however, this fact notwithstanding, substantive standards for the recovery of cost and fee awards in tax cases should not vary from those which are applicable to other civil litigation.

Mr. Chairman, members of the subcommittee, in 1982, as part of the Tax Equity and Fiscal Responsibility Act (TEFRA), Congress promulgated provisions for the award of court costs and certain fees in civil tax cases. These provisions, found at 26 U.S.C. § 7430, appeared to be partially in response to the enactment of the Equal Access to Justice Act (EAJA), which permitted prevailing parties to obtain awards of attorneys' fees and other expenses against the United States in certain administrative proceedings and judicial actions. In that the EAJA was interpreted to be applicable to civil tax matters in the United States District Court and the United States Court of Claims (now U.S. Claims Court), but not the United States Tax Court, provisions for costs and fees when included in TEFRA. The effect of the TEFRA fee and cost provisions was to eliminate all tax cases from the purview of the EAJA, presumably with the exception of cases on which fee recovery was based on traditional common law grounds, and to vest all cost and fee matters in tax cases under designated provisions of the Internal Revenue Code. In including a fee and cost provision applicable to all civil tax cases in TEFRA, Congress attempted to prevent forum shopping based on the availability of litigation costs, and acknowledged a purported need to have a cost and fee bill specifically tailored to tax cases.

Under TEFRA, taxpayers who prevail in civil tax actions in which the position of the United States is unreasonable, may be awarded reasonable litigation costs, including attorneys' fees, up to a $25,000 maximum. Whether a taxpayer "prevails" depends upon whether the taxpayer can establish that the government's position was unreasonable, and, whether he substantially prevailed with respect to the amount in controversy or with respect to the most significant issue or set of issues presented. The determination of "prevailing party," as well as the determination of whether the government's position was "unreasonable," is discretionary with the court hearing the case. A determination of what constitutes "reasonable litigation costs" is also made by the court hearing the case. Court costs, expert witness expenses, costs of studies, analyses, reports, tests or projects necessary for case preparation, as well as attorneys' fees or fees incurred by one authorized to practice before the Tax Court, are included in "reasonable litigation costs."

The standard for a cost and fee award in civil actions under the EAJA is different from the enunciated standard under TEFRA. Pursuant to the EAJA (28 U.S.C. § 2412(d)), eligible prevailing parties are entitled to an award of attorneys' fees and other expenses unless the court finds the position of the United States was substantially justified or that a fee award is made unjust by special circumstances. An individual having a net worth of more than one million dollars is not an eligible party under the EAJA; nor is a sole owner of a proprietorship, a partnership, association, corporation or private organization eligible, if its net worth exceeds five million dollars, or if it has more than five hundred employees. As to whether or not a party has prevailed, a party usually may be considered a "prevailing party" if it succeeds on any significant issue in litigation which achieves some of the benefit the lawsuit sought. The "substantial justification" standard is characterized as one of reasonableness, and courts are divided on whether the position of the United States constitutes the government's litigation position or the pre-litigation conduct of the government which was the basis for the underlying civil action. The "special circumstance" provision gives courts discretion to deny awards where equitable considerations would so dictate. Fees under the EAJA are limited to an hourly rate of $75, in the absence of an increase in the cost of living or a special factor which would justify a higher fee. Expenses covered encompass reasonable expert witness costs (up to the rate paid an expert witness by the United States), and reasonable costs of studies, analyses, reports, tests or projects necessary for preparing one's case.

Viewing the cost and fee provisions of TEFRA as compared with those in the EAJA, TEFRA presents a more stringent standard for recovery. For a party to prevail for purposes of a TEFRA fee award, the taxpayer has the burden of establishing that the government's position was unreasonable and that he substantially prevailed either with respect to the amount in controversy with respect to the most significant issue or set of issues presented. To be entitled to a fee award under the EAJA, a party must also prevail. However, "prevailing party" status under the EAJA may be more easily achieved by showing that the party has succeeded on any significant issue in the litigation which achieves some of the benefit sought. The government is relieved from liability for fees under the EAJA upon a showing that its position was substantially justified or that special circumstances would make a fee award unjust. While substantial justification has been characterized as a standard of "reasonableness," which is not dissimilar from the "unreasonable" standard for the government's position under TEFRA, the EAJA scheme differs markedly since the burden rests with the United States, and not the challenging party, to meet the burden of proof.

Fee and cost provisions under TEFRA and the EAJA both allow for discretionary action by the court (although more discretion appears to be embodied in the TEFRA provisions), and both statutes consider similar types of expenses to be those which come within the purview of a fee and cost award (although the EAJA limits the expert witness reimbursement to the maximum paid to a government expert and TEFRA allows for fees incurred by lawyers and non-lawyers who are authorized to practice before the Tax Court). A significant difference, however, lies in the amount of the award which is available to prevailing parties under the respective statutes. Under the EAJA, there is no ceiling on the total amount a party may recover, although absent special circumstances, a $75 per hour maximum is attached to fee awards. Under TEFRA, conversely, there is no hourly minimum contained in the statute but a ceiling of $25,000 is put on the overall award. Another distinction between the fee provisions lies in the fact that the EAJA sets party net worth and size limitations for eligibility, which are not found in TEFRA.

In 1984, with a view toward the October 1, 1984 sunset provision of the EAJA, Congress reviewed the implementation of the EAJA and passed certain amendments which would have modified the EAJA and enacted it on a permanent basis. Although the proposed amendments to the EAJA were vetoed by President Reagan on November 8, 1984, they are nevertheless instructive in terms of revealing Congressional intent on federal government liability for fee and cost awards. In proposing amendments to the EAJA, Congress decided to raise the net worth limitation for eligibility to two million dollars for individuals and seven million dollars for business entities. Among other modifications, Congress also clarified that the position of the government which must be substantially justified to preclude a fee award is the actions or omissions of the United States which lead to the underlying civil action. What was of particular interest in the EAJA considerations in terms of TEFRA and its fee and cost provisions, were proposed Senate inclusions within the EAJA which would have amended 26 U.S.C. § 7430. During the debate over the EAJA amendments, the Senate proposed a draft of the amendments which included a section to make TEFRA fee and cost provisions more similar to those of the EAJA. Specifically, the Senate proposed that the TEFRA fee and cost award provisions be extended to 1989 and that the statutory ceiling for fee and cost awards under TEFRA be increased from $25,000 to $50,000. The Senate also attempted to remove the taxpayer's burden of showing that the government was unreasonable in order to be a prevailing party. Furthermore, the Senate tried to impose a burden upon the Internal Revenue Service to show that its administrative actions which gave rise to the issues in the proceeding were substantially justified, in order to avoid liability for an award, absent a finding that special circumstances would make an award unjust. Such proposed amendments to TEFRA were met with stringent opposition in the House of Representatives. The House deleted the TEFRA provisions and thus the final draft of the EAJA amendments which went to the President contained no mention of any modifications to the Internal Revenue Code.

Historically, the Department of the Treasury has been opposed to any bill which would include fee and cost awards for tax cases within the context of general civil litigation. Reasoning that tax litigation encompasses peculiar problems distinct from civil litigation in general, the Treasury Department lobbied to have tax cases eliminated from the content of the EAJA. It was argued that tax cases required narrowly drafted fee and cost award provisions which would balance the twin objectives of not encouraging litigation to the point of disrupting tax collections, while not being restrictive so that a taxpayer would feel incapable of defending his interests. Specific reasons given by the Treasury as to why tax cases should be dealt with apart from other civil litigation were as follows: the heavy caseload of the Tax Court; the fear that the lure of court fee awards would discourage taxpayers from using the informal special Tax Court small case procedure; the fear that the lure of cost and fee awards would discourage settlements in the IRS Regional Office; and that since tax cases often involve many unrelated issues of fact and several taxable years, there is often no clear-cut winner. The Treasury further attempted to distinguish tax cases from general civil litigation by focusing on restraints on net worth and size limitations, versus a provision which would set a maximum award constraint. It was the position of the Department of the Treasury that unlike the typical civil matter, the more complex and sophisticated issues in a tax case, which are costly to litigate, are usually raised by wealthy individuals and corporations. In that the underlying purpose for federal government fee liability is to enable parties to redress wrongs they have suffered at the hand of the United States, and in that there exists a correlation between the amount at issue in a tax case and the taxpayer's ability to pay for litigation, the Department of the Treasury noted that net worth limitations would not serve the same purpose in tax cases as they would for civil litigation in general. Furthermore, the Treasury claimed that determinations of asset size would be difficult to ascern. Rather the Treasury purported that a ceiling limitation on the dollar amount of awards would be appropriate in tax cases in order not to encourage excessive litigation while assuring relief to taxpayers with limited resources.

A review of the rationale given by the Treasury Department for why tax cases should be treated separately from general civil litigation reveals a relatively weak argument. Each justification presented by the Treasury for separate and unique treatment appears to be equally applicable to all civil litigation. All of the federal courts have heavy case loads and the lure of awards for court costs and fees can be said to discourage settlements in any civil action in the initial stages or at the administrative level. Most civil litigation also contains multi-issues and more often than not, one party does not prevail on every issue of a lawsuit. As to the assertion that net worth limitations fail to further the purpose for cost and fees awards in tax cases, this argument can be couched as one of justification for limiting the government's liability for fee awards rather than one which holds a valid rationale. If wealthy individuals or large corporations are the ones who are involved in most of the expense-laden litigation, then a size and net worth limitation effectively will place the burden of the litigation expense on the taxpayer, while giving smaller entities access to the courts. The argument that asset size is a difficult fact for the court to determine in tax cases is an interesting one, however. In that the determination of asset size may often be an underlying issue in a tax matter, it appears that more often than not, for meeting eligibility requirements, such a provision might work in favor of the government.

In conclusion, if it is felt that the tax case situation is unique and distinctive enough from a procedural perspective to warrant separate legislation, then separate legislation is appropriate. However, what is not appropriate is lacing that separate with standards that are more stringent than those which apply to civil litigation in general. If Congress finds that there should be a ceiling put on fee and cost awards against the government, or that an hourly minimum for fees should be set, then ceilings or hourly minimums should be applicable to all civil cases. If Congress feels that the burden of showing reasonableness to avoid a fee award should rest with the non-governmental party rather than with the United States, then such standard should be applicable to all civil cases.

With the reconsideration of cost and fee awards in TEFRA coming close in time to when probable considerations for review of the reauthorization of the EAJA will occur, Congress has an ideal opportunity to approach these two pieces of legislation with a view toward equalizing the applicable standards of each. It stands that litigant in a tax case should not have a more difficult burden upon him to qualify for costs and fees against the government, or to be limited in the amount of cost or fee awards, than any other party in civil action against the federal government. It is encumbent upon Congress to determine what threshhold qualifications are necessary for a party to be eligible for a fee award from the federal government. Upon such a determination, it is encumbent upon Congress to see that those threshhold qualifications are applied uniformly to all parties in a civil law suit in which the United States is involved.

Chairman RANGEL. Thank you, Professor Hill, for the time and thought that you have given to the requests of the subcommittee. It certainly has been helpful to listen to your views, not only as a professor, but as a former assistant U.S. attorney.

I ask that the record remain open so that other members may be allowed to ask you questions through staff and hopefully you will be able to respond.

Thank you for your contribution.

Ms. HILL. Thank you, sir.

Chairman RANGEL. Our last panel, from the National Federation of Independent Business, Sally Douglas, the manager of research, and James Lagos, vice president for issues for Small Business United.

Thank you for your patience. Your testimony will be entered into the record by unanimous consent. You may proceed.

SALLY L. DOUGLAS, MANAGER OF LEGISLATIVE RESEARCH, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Ms. DOUGLAS. Mr. Chairman, I will summarize my remarks. Most of what I have said you have already heard by several witnesses today.

The National Federation of Independent Business has been a long-time supporter of the Equal Access to Justice Act. We are a supporter of fee shifting statutes that would enable private citizens, small business owners or individuals, to recover fees if they prevail in a case on merits against the Federal Government for unwarranted Federal action.

We believe the intent of Congress in passing the TEFRA legislation, section 7430 was quite similar to the underlying provisions of Equal Access.

That is, to restore the right of the private citizen to protect himself against unwarranted Government action and also to provide an incentive to Federal agencies to act more responsibly.

IRS of course is the single agency of the Federal Government that impacts the universe of small businesses. There is therefore inherently a great potential threat of unwarranted action. Past statistics indicate IRS has not always been justified and can by merit of its unique role as the revenue collector of the Federal Government do considerable damage to individuals and businesses alike. It is therefore particularly critical to our membership that this agency exercise prudence and be held accountable for irresponsible, unwarranted action.

The problems with the language that we see in section 7430 that I would like to concentrate on today have already been discussed. One of them has to do with the burden being placed on the taxpayers under section 7430 as opposed to the Equal Access standard of having the burden on the Government. There have been some comments by previous administration witnesses to that effect.

We see the award of attorney's fees as a separate matter from the case in merits. It is here that the burden shifts, for it is IRS that takes action against the individual regardless of who brings the suit. It is IRS that takes the original action that leads to the suit. And it is IRS that best knows why it did what it did.

The taxpayer should have the burden of proof in the case in merit, but as the IRS has all the relevant information concerning why they took the particular action against the taxpayer.

As Judge Sterrett said, if someone breaks a contract, the person accusing him of that contract break should have the burden of proof. Consider, then, that the IRS has accused the taxpayer of breaking his contract, if you will, and takes action against the taxpayer. The IRS therefore in that instance should have the burden of proof.

Chief Judge Sterrett also had apparently no problem in determining whether the Government has been reasonable in making a distinction between what happens after the petition is filed and what has gone on before. Several district court judges, however, appear to be quite troubled by this distinction, which the statutory language compels them to make, and which in their mind is arbitrary and without rational basis.

Even those district court judges who have ruled that they cannot award attorney's fees because the statutory language expressly forbids awards for anything prelitigation, those judges have all in their opinion stated tremendous sympathy with the problems, have stated the fact that the IRS was absolutely unreasonable in its actions before the case got to court.

It appears to be an uncomfortable position for them to have to take as well. We would urge that in your deliberations over the next few months on this very critical piece of legislation, that you look, pay particular attention to, the distinction that has been made that we feel is without merit, and that the language be changed in the authorization to include prelitigation action as well.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF SALLY L. DOUGLAS, MANAGER OF LEGISLATIVE RESEARCH, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Chairman, on behalf of the National Federation of Indpendent Business (NFIB) and its more than 500,000 members, I appreciate the opportunity to discuss our views on the award of attorney's fees in tax cases.

The Tax Equity Fiscal Responsibility Act of 1982 (TEFRA) contained a provision that taxpayers who prevail in civil tax actions may be awarded, subject to certain specified conditions, reasonable litigation costs, including attorney's fees. This provision, otherwise known as Internal Revenue Service Code section 7430, contained both good news and bad news for the small business community. The TEFRA provision caused us a great deal of consternation, because it supplanted the attorney's fee provisions of the Equal Access to Justice Act of 1980 (EAJA) as it pertained to tax cases in District and Claims Courts. The good news was that the Tax Court would for the first time be covered under a fee-shifting statute, since the way EAJA was written had precluded Tax Court coverage under its provisions.

The Subcommittee will be exploring the record under section 7430 to determine how extensively the provision has been used, the costs of obtaining an award for the taxpayer, the costs for the government in defending aginst the award, the additional time involved in pursuing or defending against awards, the effect of the provision on the Tax Court's backlog, and data on the number and types of cases resulting in awards as well as size of awards.

From what we have been able to determine to date, less than twenty awards have been made, ranging from $600 to the maximum allowed recovery rate, i.e. $25,000. We have as yet no indication of the number of cases which have resulted in award denials, nor do we have a clear picture of the grounds for denials. In some cases, the petitioner was not the prevailing party as defined under section 7430, or he did not exhaust his administrative remedies as required. In several cases, the pivotal issue was one we have encountered under EAJA, that is, the distinction between litigation posture and agency proceedings in determining whether the government's position was reasonable. In some cases, it appears the only reason awards were denied was that action was initiated in Tax Court before the March, 1983 effective date. Finally, we have no clear indication over the full range of cases as to the amounts requested in the fee petitions. we know, of course, that section 7430 sets an arbitrary limit of $25,000 for fee recovery, but we do not at this time have any indication of how this figure compares to the real costs to the taxpayer of contesting IRS' action.

As the Subcommittee moves forward in its investigation, we hope to be able to provide you with additional information to clarify the record on these points. What we can do now is discuss, in light of our experience with EAJA, some of the problems we see with the language in section 7430.

Despite the problems we have with the way section 7430 is drafted, the inclusion of tax cases under a fee-shifting statute is of paramount importance to our membership. Let me try and explain why.

Our support for statutes which permit prevailing parties to recover attorney's fees and court costs was originally based on the unprecedented increase in Government regulation and the impact that was having on small business owners, who became esy targets for unwarranted actions by federal agencies. It has been well-documented in legislative history, and I do not think I need to go into any great detail, but the problem that our members found themselves in was that for economic reasons, rather than the merits of the cases, they were coerced into compliance with unwarranted, capricious, arbitrary actions by the Federal Government simply because they did not have the resources to contest the action. We had complaints from members about $100 fines from an agency. The $100 was not what bothered them. It was the idea that they had no recourse, that it would cost thousands of dollars to take the agency to court and try to win the case.

The Equal Access to Justice Act intended to remedy this situation by placing the Government and small business on a more equal footing. It helped to mitigate the economic impediments and allowed a decision by a small business to contest an action solely on the basis of the merits of the case.

We see the act as being intended to accomplish two purposes, that is, to restore to the small business owner his right to protect himself against unwarranted Government action and also to provide an incentive to Federal agencies to act more responsibly.

IRS is the single agency of the Federal Government that impacts the universe of small businesses; there is inherently a greater potential threat of unwarranted actions. Past statistics would indicate that IRS is not always justified and can, by merit of its unique role as the revenue collector of the federal government, inflict considerable damage to individual and business alike. It is therefore particularly critical that this agency above all others exercise prudence and responsibility and be held accountable for irresponsible, unwarranted action.

One of the most important things equal access to justice did for our members was to switch the burden of proof that always used to rest with them over to the Government. We see this as a very common sense basis to the legislation, that being that the party who has easiest access to and the most knowledge of the facts in question should bear the burden of providing that they were substantially justified in their actions. It is far easier for the Government, obviously with all the facts at hand, to explain why a particular action was taken, than it is for the small business to try and garner all the facts and present the case that the government was not justified in its actions.

I address this particular comment to the provision in section 7430 that switches the burden back on the taxpayer in IRS cases. Consider for example, a situation in which IRS assesses a penalty on an individual for unpaid taxes. The individual contests the penalty. Under section 7430, if the private party prevails and petitions for fees, he must prove that the IRS was unreasonable in its actions. But how could he do so if the IRS never at any time during the course of the proceeding presented the individual with any specific finding of fact on which the assessment was based? What if IRS never gave him any reason or justification at all for its actions? In denying access to the facts, IRS deprives the individual of any opportunity to refute the claims. How just is it then to put the burden of proof on the individual when the IRS is in possession of the memoranda, interview sheets, or whatever was used in making the determination? Without extensive discovery, the individual would have little or no chance of proving the position of the IRS was factually and legally untenable.

The scenario I have described is not fantasy, it is fact. Such a case was litigated in District Court, and fees were awarded to the private party under EAJA. In that instance IRS bore the burden of proof and presumably made the best effort possible to establish a strong record to prove its position was substantially justified. Had the fee petition been filed under section 7430, the IRS might not have been as forthcoming with evidence.

A second problem we see with the language in section 7430 is the litigation posture vs. agency proceeding controversy. As I said before, we have experienced this problem with EAJA, with courts dividing over the issue of whether the position of the United States is interpreted as the litigation posture or whether the agency action which initiated the litigation must also be reviewed in determining the government's position. In most cases there is no fundamental difference between the two, since the litigation position will almost always be that the agency action was legally justifiable, but making an arbitrary distinction between the two for purposes of determining whether an award should be made can make a decided difference in the outcome of the case. As senior Judge Oliver stated in his opinion on *Moats vs. U.S.:*

"The Government's litigation position was that its underlying action was legally justifiable, therefore, to determine the reasonableness of its position it is not enough to examine only the Government's position before this Court. Litigation does not exist in a vaccum, the litigation position of the Government cannot be insulated or extricated from the underlying factual and procedural background of the case especially where, as here, the litigation position is an adoption of the underlying agency action."

The ambiguity of the EAJA language is, unhappily, not the problem with section 7430. The section reads clearly that "the position of the United States *in the civil proceeding*" (emphasis added) is the position that must be shown to be unreasonable before fees can be awarded. Presumably proponents of litigation posture won the TEFRA battle. Because of this language, fees have been denied to some parties, and courts have been forced to rule, "no matter how sympathetic the [court] may have been with respect to his concern over the prior administrative proceedings" (*Edison vs. U.S.*), recovery of attorney fees must be limited to unreasonable positions taken by the government in civil proceedings and does not extend to unreasonable positions taken at the underlying administrative proceeding. Courts have had to reason that "the statute was not intended to deter administrative abuses" (*Zielenski vs. U.S.*), and fees must be denied "even though the acts of United States employees were clearly unreasonable prior to the litigation" (*Brazil vs. U.S.*).

In only two cases that I know of, the District courts issued opinions contrary to the aforementioned opinions. In both cases, the courts could not accept the arbitrary distinction between litigation position and the agency action which led to the litigation. We concur with the opinion of District Judge Paine when he says:

"This Court has identified no rational basis for making a distinction between the Government's position in initiating the [action] and the Government's position in defending that [action]. It is, after all, only one Government. If the Government's position in initiating the [action] was found to be unreasonable (as it was in the instant action), it is hard to fathom how the Government's position (in defending an unreasonable action) would be reasonable. Similarly, if the Government's position in initiating the [action] was found to be reasonable, the Government's position in defending that reasonable action could rarely itself be unreasonable" (*Penner vs. U.S.*).

The problems I have described are two which have proved to be critical in cases under EAJA's purview and have already been significant factors in tax cases under section 7430. They merit serious attention by the Subcommittee, as do concerns about the $25,000 fee cap the difference in standards, i.e. "reasonableness" under section 7430 and "substantial justification" under EAJA.

Underlying both EAJA and the TEFRA provision is Congress' belief that the threat of fee awards would deter abusive actions or overreaching by the government and permit individuals and businesses to fight on the merits without being hampered by economic considerations. This is a belief we wholeheartedly share, but we must exercise some care to ensure this belief can become a reality. We look forward to working with you on this most critical issue for small business.

Chairman RANGEL. Thank you.

Mr. Lagos.

STATEMENT OF JAMES H. LAGOS, VICE PRESIDENT FOR ISSUES, SMALL BUSINESS UNITED

Mr. LAGOS. Thank you very much, Mr. Chairman.

I am Jim Lagos. I am a volunteer small business advocate. I serve as the vice president for issues of Small Business United. Small Business United is a confederation of State small business organizations wherein all of the members come to Washington on occasion to lobby for the positions of small business.

All of us always pay all our own expenses including the expenses to come here today. This particular provision of the law is of extreme importance to small business. That is because every small business, whatever type of business they have, has contact with the Internal Revenue Service.

This is the agency which causes more problems for small business we believe than any other Federal agency, simply because all of the small businesses do have contact with this particular agency.

I am humble to be following the witnesses who have testified here today, most of whose first names appear to be honorable. However, small business can no longer afford to be shy, and I will certainly not let my humility stand in the way of saying that a number of the things said by the previous witnesses are somewhat wrong.

The principal contacts that most small businesses have with the IRS is not at the tax court level, where you have attorneys who are specialists working for the tax court, where you have all sorts of rules prevailing and so forth. The tax court is like that eagle up there on top of those columns, and we small businesses are down here in the trenches.

The primary problem that we have with the IRS is not with the generals, it is with the privates out in the field. And I submit to you essentially that the 20 cases or so that have been—less than 20 cases that have been decided under this particular statute do not reflect accurately the problems that small businesses throughout this country have with the IRS.

In talking at our meeting to small business counsel in Springfield, OH, we have more complaints than that about unreasonble IRS activity just in our town. And I think that is true of all of our member organizations.

And I submit to you that the reason that you are not getting more decisions favorable to small business people under this particular section of the law is because the position of the United States is the position that is decided by the Government once a petition gets filed with the tax court or some other court.

And 99.9 percent of the cases involving small businesses don't even get that far. So, basically, it is absolutely critical that the position of the United States include the underlying agency action.

As your staff was on top of it, the *Kaufmann* case indicated that that could be considered. I compliment your staff on that. By the way, I appreciate them being here also today.

But as I say, the main problem that we have is the underlying agency action. If we eliminate that, then basically you are leaving in place the principle problem that small business does have with the IRS as such.

Chairman RANGEL. What basis do you have for raising the fee ceiling?

Mr. LAGOS. I will be honest with you. I am a small town lawyer. My brothers and I practice together. A $25,000 fee to us is an extremely exorbitant high fee. The reason I would have that in would be as a safety valve. There have been cases mentioned to us by our members where the IRS will say "we are attempting to make law on a particular type of case," and because they are attempting to make law, they will appeal something, perhaps to the U.S. Court of Appeals or whatever, and the small business then has the burden of proof following the case through the Court of Appeals, and this can drag on for years.

Chairman **Rangel**. It is an arbitrary ceiling. I would be inclined to agree with you, except nobody unfortunately has given any evidence to indicate that the $25,000 ceiling has caused any hardships. I was only trying to solicit whether or not you had specific reason to believe——

Mr. **Lagos**. Basically just as a safety valve.

The other point I wish to disagree with some of the prior witnesses is insomuch as the burden of proof. The burden of proof frequently decides who wins the case. And I submit to you that that the burden of proof should be on the IRS, once they have already lost. And I don't think that this is going to cause any backlog in the Tax Court at all.

I feel very strongly that basically a judge, when he is sitting there listening to the evidence, and is trying to decide the case, already in his mind is thinking, whatever kind of case you have, the judge is already listening to the evidence and already making up his mind as to what type of a case there is here—if the case is an idiotic case and never should have been brought in the first place.

And I don't think it is going to take that much more effort or cause that much of a backlog to have the burden of proof switched to the Internal Revenue Service.

In Ohio, we just enacted our own Equal Access to Justice Act. We placed the burden of proof on the Government. That was passed unanimously by all of the Democrats and all the Republicans in both the Senate and the Ohio House of Representatives who felt very strongly that the burden of proof should be on the Government.

Essentially the types of situations that small businesses find themselves in are this: The Government frequently will shy away from attacking a large business, a large corporation, because that business they know is going to be able to hire tax lawyers, that business is going to be able to come in with CPA's and so forth. The small business that goes to the audit hearings with an accountant who is not even a certified public accountant, which is a typical case, or the small business person goes by himself, that person is particularly subject to being picked upon by the Government.

And I submit to you that basically once that person can establish, if he does go all the way up the ladder, that in fact he has a prevailing position, then the Government should have to pick up all the expenses and the Government should have the burden of proving that the position was at least reasonable.

I submit to you that small businesses are not going to be litigating these cases just to be litigating them. When the small business person gets involved in any type of administrative proceeding or any type of court proceeding, that person who is the key person of a business is away from the business.

So the fact that you are paying for his attorney's fees doesn't really make that person whole anyhow. He or she is still out, because they have to take time away from their business. Small business will avoid litigation like the plague, and continue to settle cases any way they can to avoid getting invovled with the Government.

Mr. Chairman, I wish to thank you very much for having these hearings and giving small business the opportunity to be heard. If you have any questions, I would be more than happy to try to answer them.

[The prepared statement follows:]

STATEMENT OF JAMES H. LAGOS, VICE PRESIDENT FOR ISSUES, SMALL BUSINESS UNITED

Mr. Chairman, this witness is a volunteer small business advocate representing Small Business United which consists of nine state and regional small business organizations. Our member organizations represent thousands of small businesses of every type. This week several hundred of our members gathered in Washington to present our program directly to our elected representatives. We all donate our time and pay our own expenses at all our activities because we believe that our future and the future of our country is dependent on the health of small business.

The reenactment of the provisions of 26 USC 7430 is crucial to small business. Most small businesses have more contact with the IRS than any other federal government agency. *All* small businesses make use of 26 USC 7430. This is true even if a particular small business has never been audited by the IRS. This is because 26 USC 7430 is primarily designed to serve as a *deterrent* to IRS persecution of small business.

We do not have exact statistics available to us as this testimony is being written. We believe, however, that the provisions of 26 USC 7430, however, are relatively simple to administer, consume little additional time by the taxpayer and the government and are not overly burdensome on the Tax Court's backlog. Any Judge who is listening to a case is already thinking about whether the government's position is reasonable. He should already have his mind made up on that issue by the time he decides the case. It is then a simple matter for the prevailing taxpayer to produce his time and expense sheets for a determination of a dollar amount.

Reenactment of 26 USC 7430 should not cost the federal government a dime. If the managerial personnel at the IRS are doing their job, their employees should already be prohibited from taking unreasonable positions in dealing with small business. Any IRS employee who does cause the government to lose money under 26 USC 7430 should be looked at carefully to see if he is doing the job for which he is paid.

Indeed, 26 USC 7430 actually saves the federal government money. "Positions" which are not "reasonable" are not just a burden upon small business. They are a burden and an enormous expense upon the federal government. Every time a federal bureaucrat persecutes a small business, it costs the federal government money. We believe the provisions of 26 USC 7430, by deterring unjustified federal actions, actually save the federal government money in the long run.

The United States Congress, and indeed, the President and the members of his Cabinet, have precious little control over the day-to-day activities of the federal bureaucracy. The bureaucracy actually has a mind of its own. 26 USC 7430 helps to change all of this nonsense. It provides a management tool to help oversee the federal agency that the Congress created and that the President was to oversee. By studying the annual report of how many awards involving how much money are made under 26 USC 7430, the Congress and the President are able to see how often the IRS is engaged in positions which were not "reasonable". The offending bureaucrats stick out like a sore thumb. Reenactment of strong 26 USC 7430 is desperately needed in order to permit the United States Congress and the President and his Cabinet to keep a handle on the IRS bureaucracy.

Small businesses are not just miniature large businesses. They are different in kind as well as in size. Federal government actions affect small businesses differently than large businesses.

The nation's small business community bears the brunt of the octopus of federal administrative regulation. Large businesses have departments of experts who can work full time on dealing with the federal bureaucracy and its maze of adjudication hearings. They are also in a position to hire large law firms with attorneys who specialize in this area of practice. Federal bureaucrats are aware of this and often shy away from confrontations with the large businesses in favor of attacking small businesses who are easier targets.

Small business owners frequently "knuckle under" to the demands of federal agencies rather than stand up for their legal rights. This is because they cannot afford to pay lawyers and other experts to defend them. A fight with a federal agency lasting for months or years can be a tremendous burden for the usually cash-short small business person. He can win this battle and still lose the war in the sense of bearing the high expense burden associated with such a fight. Small wonder that many small business people bite their lips and meekly obey the edicts of the federal bureaucracy. These are the reasons that the delegates of the Small Business National Issues Conference in June, 1984 selected reenactment of strong equal access to justice legislation applicable to the IRS.

Small Business United believes that not only should 26 U.S.C. 7430 be reenacted, but that it should be strengthened by four amendments.

These are:

(1) The "position of the United States" should mean the Tax Court shall look to the underlying Internal Revenue Service (IRS) action;

(2) The $25,000 maximum legal fee ceiling should be raised to $50,000;

(3) The initial burden of proof should be switched from the taxpayer to the federal government; and

(4) The sunset date of 26 U.S.C. 7430 should be changed from December 31, 1985 to December 31, 1989.

Mr. Chairman, Small Business United thanks you and the members of your subcommittee for the interest you have demonstrated in small business by holding these hearings.

Chairman RANGEL. I want to thank you both. I have especially been struck by your remark that Small Business United conducts their business at their own expense. I do recognize the terrific burden of proof for small businesses to try to turn around the decisions made by a powerful agency or department in Government. Your individual statements and testimony make a lot of sense, and certainly will be considered in the committee's deliberations.

I might add, and I think you would recognize it makes some sense, that if we had some idea as to the extent of your membership, to show that your views represent more than just your well-thought-out opinions, I can assure you as the chairman of the subcommittee that I would attempt to give more attention to that, to try to bring some balance to the testimony which the committee receives.

Ms. DOUGLAS. Mr. Chairman, can I make a point to that?

NFIB goes through a fairly tortuous procedure every year to determine what issues are of major priority to our membership. We poll our membership on the issues before we determine a position.

This year we did something new—another outreach effort. We tried to get, if you will, a second point of view about how our members feel about things from our field representatives, who are out there every day meeting our members and making new members of small businesses.

Of a range of issues, which started at the top with the budget deficit and ranged all the way down to very industry-specific things, including IRS under a fee-shifting statute, attorney's fees provisions came out the No. 1 priority. I think that speaks to the importance of the issue for the 500,000 members of NFIB.

And I can assure you if you are going to move legislation to reauthorize this, we want to work with you, and we can help make the case for you in Congress.

Chairman **Rangel**. Well, it would be helpful if you could submit to the record your membership as well as your survey that you took.

Ms. **Douglas**. Certainly. Be happy to.

[Additional information follows:]

ISSUE PRIORITIZATION

Issue	Rank		
	Legislative staff	Field	
		Those voting	Total
Budget:			
A. Freeze Federal spending	8.9	9.4	9.4
B. Budget process reform (2 year budget, Binding budget resolutions, etc.)	5.9	6.2	5.3
C. Line-item veto/deferrals and recissions	5.3	8.4	6.9
D. Balanced budget amendment	4.96	8.8	8.4
Taxes:			
A. 2-year moratorium on tax changes		6.7	5.7
B. Retain indexing	9.4	8.1	7.7
C. Oppose surtax	9.3	7.1	6.1
D. Payroll taxes	8.0	8.3	6.0
1. UC coverage of corporation officers		5.9	4.8
2. Increase UC exemption for agricultural workers		4.9	4.0
3. Deduct ½ self-employed FICA tax		7.3	5.6
E. Business continuation issues	7.7	5.7	1.6
1. Exempt small business from estate taxes		8.1	7.7
2. Imputed inteest		5.5	4.2
3. Installment sales		4.4	3.6
F. Expensing ($100,000)	6.3	5.7	4.9
G. Protect corporate tax graduation	6.0	6.4	5.8
H. Fringe benefit equity	5.9	5.2	4.3
I. Jobs tax credit	5.4	5.4	4.9
J. Cash accounting	2.4	6.7	6.1
SBA Reform (Including preserving agency)		3.4	.8
Regulatory Reform:			
A. Paperwork Reduction Act reauthorization	7.8	7.5	6.1
B. Equal Access to Justice Act reauthorization	7.3	7.8	6.7
C. Equal access over IRS	6.4	9.5	9.0
Finance:			
A. Banking de-regulation issues	8.2	6.0	3.7
1. Close non-bank bank loophole		5.1	3.7
2. Close South Dakota loophole		4.5	2.1
3. Keep banks out of insurance, real estate, etc		8.5	6.9
B. Capital gains rollover	5.6	6.6	5.4
Regulated Industries:			
A. Telephone access charges	6.96	8.2	7.4
Labor:			
A. OSHA reform	6.0	5.6	5.1
B. Comparable worth	7.8	4.1	3.5
C. Youth opportunity wage	6.4	5.9	5.6
D. Unemployment compensation trigger	6.2	6.1	4.4
E. FLSA threshold (minimum wage)	4.3	6.4	4.8
F. Contracting labor laws reform	5.8	8.8	6.3
1. Davis-Bacon Act		8.5	6.9
2. Walsh-Healy Act		5.8	3.3
3. Service Contract Act		5.9	4.0
G. Employment/training tax credit	4.7	5.7	4.0
H. Product liability		7.2	6.5
I. Immigration		5.9	5.4
Trade:			
A. Pro-free/anti-protectionist trade policy (includes domestic content)	5.5	7.9	5.3
B. Small business trade advocate	5.2	5.4	3.9
C. Consolidate trade functions	4.6	4.8	3.0

ISSUE PRIORITIZATION—Continued

Issue	Rank		
	Legislative staff	Field	
		Those voting	Total
D. FSC for service industries	2.5	3.0	1.71
Government Competition:			
A. Close prompt pay loopholes	4.4	7.6	7.2
B. Increases contracting out	5.0	8.6	7.4
Pensions:			
A. Federal employer pensions	5.7	7.3	6.2
B. Moratorium on pension rule changes	4.3	6.5	4.9
C. State/local employee pensions	3.6	6.2	5.3

Chairman **Rangel**. Mr. Lagos, how many members belong to your independent organization?

Mr. **Lagos**. Basically our Ohio organization, which is the Ohio Small Business Council, has 16,000 members. We are a confederation of State and regional organizations. The exact figures I don't have with me here today. I can certainly provide that. We cover primarily the northeastern and midwestern parts of the country with State organizations.

Essentially we are a grassroots type of organization. The Ohio organization is typical. We are a confederation of all the small business councils of all of the local cities. They then go together to form the State organizations. The State organizations go together to form the national organization.

Chairman **Rangel**. Well, I am not challenging your credibility, because, as I pointed out, your testimony made a lot of sense. You can understand that a lot more weight might be given by the Members if we knew exactly the organization that you represent.

Mr. **Lagos**. Very well.

Chairman **Rangel**. Our record will remain open. We will appreciate it if you see fit to submit the additional information. At this point I want to thank you very much. I ask that the opening statement of the ranking minority member, Congressman Guy Vander Jagt be entered in the record.

The meeting stands adjourned subject to the call of the Chair. Thank you very much for all of our witnesses.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

American Bar Association,
Washington, DC, April 30, 1985.

Joseph K. Dowley,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, DC.

Dear Mr. Dowley: This letter is submitted for inclusion in the printed record of the above-identified hearing.

The hearing was held in view of the fact that section 7430 of the Internal Revenue Code, which authorizes the award of attorneys' fees and other court costs in civil tax proceedings, is to expire by its terms at the end of this year.

The American Bar Association has long endorsed the principle that the government should, under proper circumstances, pay the attorneys' fees of its private adversaries in judicial proceedings. A policy position adopted by the Association in 1978 supports legislation allowing the United States Tax Court to award attorneys' fees to prevailing private litigants.

Expiration of section 7430 would eliminate any basis for recovery by taxpayers of attorneys' fees in the Tax Court. This is so because the Tax Court had held that, as an Article I court, it is not authorized to award attorneys' fees under the Equal Access to Justice Act, which applies only to proceedings before administrative agencies and Article III courts. McQuistion v. Commissioner, 78 T.C. 807 (1982). Approximately 90 percent of all federal civil tax proceedings are in the Tax Court.

Permanent enactment or extension of section 7430 would be consistent with the American Bar Association's policy position supporting awards of attorneys' fees to taxpayers in Tax Court proceedings. For that reason, and because section 7430 provides consistent standards and procedures for fee awards in civil tax proceedings in all federal courts, the Section of Taxation supports legislation to prevent expiration of section 7430.

Sincerely yours,

JAMES B. LEWIS,
Chairman, Section of Taxation.

QUARLES & BRADY,
Milwaukee, WI, April 29, 1985.

Mr. JOSEPH DOWLEY,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington DC.

DEAR MR. DOWLEY: I am writing to urge the extension of Internal Revenue Code §7430, now due to expire on December 31, 1985, regarding awards of litigation costs where the Government has been unreasonable. I recently received such an award in a refund case in the U.S. District Court for the Western District of Wisconsin. The substantive tax question was decided in our favor on summary judgment and that decision is reported as *Bystry* v. *U.S.*, 596 F. Supp. 574 (W.D. Wis. 1984). The separate decision on the motion under §7430 has not yet been published.

My case was exactly the sort of which §7430 was intended and I can assure you that our clients would not have received justice without the award of litigation costs in addition to the tax refund, itself. The amount of tax at issue was only $11,806, but the litigation costs, which unfortunately bear no necessary relationship to the amount of tax at stake, amounted to $12,182.55. We handled this case on the tightest possible budget, but tax litigation is just plain expensive. We proceeded with this particular case only because we were absolutely sure that we would win and we knew that the interest on the tax refund would still provide a substantial net recovery. Only the award of litigation costs, however, made the taxpayers whole. The Government lawyer, I might add, had the nerve to argue that our fees were unreasonable per se because they exceeded the amount of tax at issue. As we pointed out to the Court through some very pertinent legislative history, that is precisely the attitude at which §7430 was aimed.

I can tell you from my personal experience that a taxpayer does not lightly undertake a motion for an award of litigation costs. Such a motion means additional legal fees and, unless there is a pretty good chance of success, most taxpayers would not want to run the economic risk of making a losing motion. My point is that economic considerations should serve to limit §7430 motions to the few cases of truly unreasonable behavior by the Government. An additional check inherent in the system, of course, is the good judgment of our federal judges.

In summary, I feel that §7430 is a very useful tool in the proper case and it is very unlikely to be abused. In those rare cases where a taxpayer can reasonably invoke this provision, it is the only way to achieve a truly just result.

Yours very truly,

NORMAN J. BRUNS.

RICHARD S. COTLER, P.A.,
Hollywood, FL, April 26, 1985.

JOSEPH K. DOWLEY,
Chief Counsel of Committee on Ways and Means, Washington, DC.

DEAR MR. DOWLEY: This office had reason to become involved with the above-mentioned statute in connection with a request made to the Tax Court for reimbursement of reasonable litigation costs. The Tax Court subsequently denied the motion in a memorandum decision written by the Honorable Chief Judge Dawson. See *Spirtis* v. *Commission,* T.C. Memo. 1985-44 (January 28, 1985). At issue in the case was the meaning of the words "civil proceeding" as used in the statute. It is the primary purpose of this letter to encourage this Committee to recommend not only the extension of the coverage of the statute past proceedings commenced prior to December 31, 1985, but to recommend that the term "civil proceeding" be statutorily defined to include not only the litigation conduct of the Internal Service but to also include the conduct of the Internal Revenue Service at the administrative level.

The ambiguity of the phrase "civil proceeding" and the lack of legislative history regarding enactment of 26 U.S.C. § 7430 has resulted in this issue being litigated at both the Tax Court and District Court level as well as in one case at the Court of Appeals level. The District Courts have varied on this issue. For example, in *Hallam* v. *Murphy*, 84-1 U.S.T.C. ¶ 9230 (N.D. GA. 1983) and in *Kaufman* v. *Egger*, 84-1 U.S.T.C. ¶ 9500 (D. Me. 1984) affd. 84-1641 (1st. Cir. 1985), the courts in question specifically held that the prelitigation conduct (i.e. prior to and the issuance of a statutory notice of deficiency in the case of a Tax Court proceeding) of the Internal Revenue Service is considered in determining whether the Service's position was unreasonable. On the other hand, the District Courts in *Zielinsky* v. *United States*, 84-1 U.S.T.C. ¶ 9514 (D. Minn. 1984) and in *Eidson* v. *United States*, 84-1 U.S.T.C. ¶ 9182 (N.D. Ala. 1984) and the Tax Court in *Baker* v. *Commissioner*, 83 T.C. 822 (1984) and *Spirtis* v. *Commissioner (supra)*, have held that the unreasonable conduct of the Internal Revenue Service is measured only after the legal proceeding is commenced, or in the case of a Tax Court proceeding, only after an answer is filed.

It is the belief of the undersigned that the latter view is an erroneous interpretation of the intent of Congress. It is my belief that Congress intended that a taxpayer be reimbursed out of the public fisc in those situations where the unreasonable conduct of the Internal Revenue Service has forced a taxpayer to use the legal system to redress his grievance. This belief is bolstered by the fact that in many situations, the cost to the taxpayer in terms of court costs and attorneys fees, often exceeds the benefits to be derived by litigating his rights. It was this wrong that Congress intended to make right.

One of the stated purposes of this Committee hearing was to review the effectiveness of the statute. It has been told to me and it is my experience, that the policy of the Internal Revenue Service is to flatly refuse all requests for reasonable litigation costs and to force all requests to be litigated. This policy, when taken in conjunction with a position that the term "civil proceeding" only refers to litigation conduct, would mean that a taxpayer would never receive litigation cost reimbursement. My reason is as follows: Presumably, as one progresses up the Internal Revenue Service hierachy, the level of competence increases. That is to say, an appellate conferee would have a better understanding of the tax code and related judicial decisions than would a revenue agent. Likewise, the Service's trial counsel (District Counsel) would have a better understanding and be more competent than would be an appellate conferee. Thus, by the time Internal Revenue Service trial counsel makes a detemination to proceed with litigation, it is safe to say that the Internal Revenue Service would have some legal authority for their position. This in turn would preclude a finding of unreasonble conduct at the trial level.

The First Circuit Court of Appeals, in *Kaufman, supra,* realized this in holding that the unreasonable conduct of the Service also refers to conduct at the administration level. That Court further reasoned that litigation does not occur in a vacuum. Thus, where the Internal Revenue Service's conduct at the administrative level was unreasonable, and where the Service's Trial Counsel, owing to his superior legal education and competence, realized that the position of the Service was unjustified, resulting in a prompt settlement of the case, in this situation a Taxpayer is entitled to reimbursement for litigation costs. Please do not misunderstand, neither the Court in *Kaufman, supra,* nor the undersigned, is advocating reimbursement for attorneys fees at the administrative level. However, a taxpayer should be reimbursed for legal fees incurred in the filing of a Tax Court Petition if the filing was made necessary by the unreasonable conduct of the Service.

This reasoning has its basis in logic. By analogy, if a child made a mess he would still be scolded even though he promised to clean up the mess. By the same token, if the Service's conduct was so unreasonable as to force a taxpayer to seek legal redress, the Taxpayer should be compensated for those legal fees and costs incurred. This should be so even if upon initiation of a suit, the Service immediately settles the case.

Finally, in considering this issue, the Committee should be aware that it is the practice of many Tax Attorneys to charge a minimum fee for filing a Tax Court Petition and to work on an hourly basis in the event the hours exceed the minimum fee. For example, this office usually charges a minimum fee of between $1,000 to $2,000 to file a Tax Court petition. This office must do so because regardless of the simpleness or complexity of a case, one must always be concerned with the accidental failure to file within ninety (90) days or any other unexpected occurrence. Thus, it would be erroneous to assume that if the Service promptly settled a case, the Taxpayer's costs would be minimal.

I thank you very much for your valued time in reading these comments and would hope that this letter plays some small part in the enactment of a statutory definition of "civil proceeding".

Sincerely,

TED KLEIN,
Law Clerk.

DAY & MCBRIDE,
Oakland, CA, May 8, 1985.

J.K. DOWLEY,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, DC.

DEAR MR. DOWLEY: It is respectfully requested that the following information be provided to the subcommittee for their consideration in reviewing Title 26, United States Code, Section 7430.

I feel that there is a necessity for the availability of awards for attorney fees and costs in litigation in which the government's position is unreasonable in order to protect the rights of taxpayers, especially in situations where the taxpayer would not be able to afford counsel to contest unreasonable conduct by the Internal Revenue Service.

In one particular case in which I represented a taxpayer, the taxpayer could not afford, or even advance, attorney fees, and eventually I was required to look only to the court for the award of attorney fees. The Internal Revenue Service's position was so ridiculous that I undertook the case, relying only upon the opportunity to seek the award of attorney fees from the government. In such case, the United States District Court did find the award of attorney fees appropriate in that the government's position was without justification. This, of course, did not compensate the taxpayer, a single mother who was the sole support of her fourteen year old daughter, for the damages she incurred from the government's unreasonable action.

In addition in a recent telephone conversation with an Assistant United States Attorney regarding another case, such attorney highlighted the problems faced by private counsel in dealing with the Internal Revenue Service. In this recent case, the conduct of the Internal Revenue Service (pre-litigation) has clearly been unreasonable and I am convinced that, by review of such conduct by the United States District Court, an award of attorney fees in cost would be appropriate. In this case, after approximately four years of attempting to resolve the dispute with the Internal Revenue Service, the taxpayer had no recourse but to retain this office to file legal action. As soon as the legal action was filed, the government acknowledged for the first time the fact that an erroneous assessment of taxes existed, and agreed to account for approximately $50,000 paid by the taxpayer which, prior to such date, had never been accounted for by the Internal Revenue Service.

On May 3, 1985, in a conversation with the United States Attorney, it was stated that, in order to settle the case, the taxpayer would be required to waive the right to make a motion for attorney fees and costs pursuant to Title 26 United States Code. This, according to the United States Attorneys office, was a position being taken by the Regional Counsel of the Internal Revenue Service.

Such conduct as that described above has prompted me to submit the following regarding the interim and other amendments to Title 26, United States Code, Section 7430:

1. Pre-litigation (unreasonableness). It is submitted that the statute (Title 26, United States Code, Section 7430) should be amended to clearly allow for the award of attorney fees and costs prior to the filing of litigation where the Internal Revenue Service's action is unreasonable. If in fact the attorney fees and costs were only allowable following the filing the complaint in the United States District Court or Tax Court, such statute would only encourage counsel for the taxpayers to file the complaint with the court at the earliest opportunity and at the earliest sign of unreasonable conduct with the Internal Revenue Service in order to "start the meter" for potential attorney fees and costs award. It would discourage continued negotiations in the attempt to resolve disputes without resort to legal action.

The limiting of attorney fees and costs to post-litigation would further encourage the Internal Revenue Service to act in an unreasonable manner, knowing that such agency could always concede the case immediately after the filing of a complaint or petition and, thus, minimize the damage exposure. The Internal Revenue Service should not be allowed to act unreasonably, force a taxpayer to litigate a matter, and then "roll over" in the court to limit the attorney fees and damage awards for past unreasonable conduct. The taxpayers' attorney fees and costs is directly related to unreasonable conduct by the Internal Revenue Service and such taxpayers should be compensated for such additional cost. In addition, the granting of attorneys' fees for pretrial conduct will make the Internal Revenue Service more responsive to the needs of the taxpayers.

2. Limited Use-Intimidation. I understand the Internal Revenue Service has stressed the point that only twenty attorneys in the United States have been awarded attorney fees and costs pursuant to the statute under consideration. Unfortunately, the statute is not used to the full extent inasmuch as the United States of America and the Internal Revenue Service engages in a campaign of intimidation to restrict the taxpayers' rights to use the statute. As evidenced above, the United States of America (Internal Revenue Service) will not negotiate toward a settlement of a case unless the taxpayers waive their rights to submit to the court the issue of attorney fees and costs pursuant to Title 26, United States Code, Section 7430. With such policies in effect, Congress should weigh lightly any evidence submitted by the Internal Revenue Service that the necessity for the extension of a statute does not exist inasmuch as there has been limited use of such statue.

Conclusion. It is respectfully submitted that the statue should be clarified to clearly reflect that the "pre-litigation" unreasonable conduct of the Internal Revenue Service may be examined to permit an award of attorney fees and costs based thereupon. This statute is essential so that taxpayers who could otherwise not afford attorney's fees and costs may have an equal opportunity to challenge Internal Revenue Service's conduct which may be found unreasonable and without justification.

Respectfully submitted,

MONTIE S. DAY.

DOMINICK, FLETCHER, YEILDING, WOOD & LLOYD, P.A.,
Birmingham, AL, May 15, 1985.

Mr. JOSEPH K. DOWLEY,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, DC.

DEAR MR. DOWLEY: This is a written statement for inclusion in the printed hearing record of the House Ways & Means Select Revenue Measures Sub-Committee hearing held April 25, 1985, concerning the expiration of Internal Revenue Code Section 7430.

Prior to enactment of Section 7430, Internal Revenue Service personnel frequently admitted that they had no sound basis for some of their positions but that they knew it would cost more in attorney's fees to challenge them than the taxpayer could recover in tax. Although the present version of Code Section 7430 is not very strong, it has had some effect in restraining this improper tactic of the Internal Revenue Service.

The Code Section needs to be amended to eliminate is technique of taking an unjustifiable position and then conceding the case immediately before trial. Currently I have a case wherein the Internal Revenue Service sought to enforce a statute that was repealed in 1954. By reading technical advice memorandums, I learned that my client is not the only taxpayer being abused with respect to this repealed Code Section.

The Service refused to resolve this case and forced my client to litigate. The Justice Department could not concede the case because the Internal Revenue Service refused permission for them to concede. After pre-trial conference, and after we had prepared a Motion for Summary Judgment, together with supporting briefs and affidavits, the Internal Revenue Service conceded. In fact, we received the telephone call conceding the case at the same moment that envelopes were being typed to serve the Motion for Summary Judgment. By this time, we had done all work necessary to win the case short of the hearing on our motion.

Our client incurred more in attorney's fees than the tax involved. The government argues that we are not entitled to attorney's fees because, they claim, that they took the position that we were correct.

When did they take this position? The took it only when they conceded the case. They had opposed us when they prepared their answer. They had opposed us during the pre-trial conference. They had opposed us during settlement negotiations. They had opposed us until we did all work necessary to win the case.

Their contention that they had not opposed us in the proceeding because of their last minute concession is ridiculous. Unfortunately, it found support in some Courts of Appeals. These decisions need to be overruled. The statute should provide that once the taxpayer has fully disclosed his case to the IRS and exhausted his administrative remedies, the position of the IRS is established notwithstanding that the IRS may later change its position during the course of the litigation.

This is merely a matter of fairness. Taxpayers have a duty to make full disclosure and give the IRS a fair opportunity to resolve the matter. The IRS, in turn, has a duty to taxpayers to make fair determinations. Once the IRS acts unreasonably, they should bear the burden of their unreasonable conduct. Concession at the last moment should not be utilized to escape the consequences of wrongful conduct.

Yours very truly,

C. FRED DANIELS.

ALEXANDRIA, VA, *April 25, 1985.*

JANE BOYLE,
House Ways and Means Committee, Washington, DC.

DEAR MS. BOYLE: In following up our telephone conversation of April 24, 1985, I am writing this statement for the record in the Committee's consideration of the extention of the application of section 7430 of the Internal Revenue Code. I am a tax attorney practising in Alexandria, Virginia, and have had a recent case that I believe should come to the attention of the Committee.

Just this month, I presented a claim for an award of litigation costs under section 7430. The award was denied. My plaintiff is a young man named David Smothers. I represented David in a successful tax refund suit in a Federal District Court for the Eastern District of Virginia, Alexandria Division. In December, 1982, the IRS had assessed approximately $3200.00 in taxes and interest against David, under the authority of section 6672 of the Internal Revenue Code, the 100% penalty statute. The IRS made this assessment without giving David any rationale for its determination and without allowing him a hearing. The details of his case may be found in the enclosed copies of the Complaint initiating the action, and my Memorandum supporting the motion for litigation costs. I also enclose a copy of the government's Answer denying most of the allegations of the Complaint. I believe that the facts of David's case offer a good example of why an attorney's fee award statute is important to maintain as a part of the Internal Revenue Code.

While I believe it is important to extend the attorney's fee act, a secondary issue has arisen which creates a need for some revision of the statute. This is the issue of "prelitigation conduct v. litigation conduct" that has been confronting the federal courts interpreting section 7430. Essentially, some courts are considering IRS administrative conduct in determining whether the "position of the United States in the Civil proceeding" is unreasonable. Others, unfortunately, are looking only to the conduct of the Department of Justice in the actual lawsuit.

The court that considered David Smothers' case took the approach of only considering the Justice Department's actions. In David's case, the Justice Department conducted a full array of pretrial discovery before deciding whether to settle the case or go to trail. After discovery was completed, Justice conceded the case completely. The court, in its inquiry into the conduct of the government attorneys, considered them to be within their rights to conduct full discovery before settling. Therefore, despite David's presentation of his full case two times at administrative stages of the Internal Revenue Service, Justice's demand to hear his story afresh, through interrogatories, requests to produce documents, and a full deposition, were considered acceptable conduct "during the civil proceedings".

I do not believe that Congress had the above interpretation in mind when it passed section 7430. At the same time, however, I cannot completely fault our local federal judges for applying the statute so strictly. Attorney's fee awards have historically been allowed in U.S. courts only under narrow circumstances. The phrase, "position of the United States in the civil proceeding," certainly lends itself to an interpretation that the administrative process is not to be considered.

On the other hand, I don't think section 7430 offers much comfort to an aggrieved taxpayer contemplating the costs of resorting to the courts, if IRS conduct is not to be considered in the analysis of the government's position. A taxpayer, like David Smothers, who has unsuccessfully spent over two years fighting the IRS over a $3,000.00 assessment, and incurring legal fees and costs along the way, will likley not care to risk the costs of a lawsuit on the mere possibility that the Department of Justice may not conduct itself in a reasonable manner. Under the interpretation of a significant number of federal courts, the current language of the statute is simply not effective in creating a useful remedy for persons injured by IRS actions.

Sincerely yours,

J. CARLTON HOWARD, JR.

Enclosure.

DAVID B. SMOTHERS, PLAINTIFF, v. UNITED STATES OF AMERICA, DEFENDANT, IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA, ALEXANDRIA DIVISION

CIVIL ACTION NO. 84-0946-A

Complaint

The above-named Plaintiff makes the following representations to this Court for the purpose of obtaining a refund of internal revenue taxes erroneously assessed and illegally collected, plus interest, costs and attorney's fees:

1. This action arises under Title Twenty-eight, United States Code, § 1346(a)(1).

2. Defendant, through the actions of the Department of Treasury, Internal Revenue Service, assessed a 100% penalty against Plaintiff on December 27, 1982, with respect to 941 tax periods 8106 and 8109, for Ivey Energy Resources, Inc. The 100% penalty assessment totaled $2,665.00.

3. On May 10, 1984, Plaintiff paid the assessed tax, plus interest of $513.87. At the same time, Plaintiff filed a Claim, Form 843, demanding refund of the payment.

4. On August 27, 1984, the Internal Revenue Service, by its District Director for the Richmond District, formally disallowed Plaintiff's claim for refund.

5. Plaintiff's claim is now ripe for federal district court jurisdiction.

The facts underlying Plaintiff's cause of action are as follows:

6. In the spring of 1981, Plaintiff was enticed into leaving his position with Service Master, Inc., in southwestern Virginia, by Mr. Sid Mullins, the president of the newly formed corporation, Ivey Energy Resources, Inc.

7. Ivey Energy Resources, Inc., was formed for the purpose of coal mining, and was located in Gray, Kentucky.

8. Because Plaintiff believed that Mullins was a friend he could trust and because Mullins owed Plaintiff approximately $2,500.00, Plaintiff accepted Mullin's offer to become the secretary-treasurer of Ivey Energy Resources. At that time, Plaintiff was 23 years old.

9. The business quickly proved to be a failure. On July 16, 1981, Mr. Norman Silvers took over the company and Plaintiff was forces to resign. Fortunately, he was able to get his Service Master job back.

10. Although Plaintiff bore the title of secretary-treasurer during his several months with Ivey Energy Resources, he had no control over financial decisions of the corporation. It was his job to maintain company payroll records. He did not, however, have sole signatory authority over company checks. Only Sid Mullins could authorize payments made by the company.

11. Plaintiff was the only officer of the corporation who was concerned about paying 941 taxes. He took all payroll information to a certified public accountant and had the Form 941 timely prepared for the second quarter of 1981.

12. Plaintiff approached Sid Mullins about payment of the withholding taxes. Without his approval, a payment could not be made. Mullins told Plaintiff not to worry about the 941 taxes. Mullins refused to allow Plaintiff to make a tax payment.

13. Largely because of the tax withholding issue, Plaintiff was asked to resign on July 16, 1981. He did so immediately. His last act as secretary-treasurer of the corporation was to sign the Form 941 for the second quarter of 1981. He was informed by corporate management that the underlying taxes would be paid.

14. Plaintiff returned to his Service Master job, was later transferred to a post of duty in Alexandria, Virginia. He had no further concern about Ivey Energy Resources, Inc., until he received a letter from the Internal Revenue Service office in Corbin, Kentucky, dated September 10, 1982.

15. The letter, addressed to Plaintiff at his former residence in Abingdon, Virginia, proposed assessment of the 100% penalty in issue. The letter was forwarded to Plaintiff's new address in Alexandria. He promptly took it to the office of the Internal Revenue Service at Bailey's Crossroads, Virginia, and gave them his correct mailing address.

16. Plaintiff soon received second from the Kentucky IRS office dated September 23, 1982. This letter gave Plaintiff 30 days to appeal the proposed 100% penalty assessment and ask for a hearing.

17. Plaintiff wrote to the Kentucky IRS office on October 14, 1982, asking for such a hearing. The IRS replied on October 19, 1982, asking him to send a Report of Interview, Form 4180.

18. Another letter from the same IRS office was mailed October 20, 1982. This letter demanded that Plaintiff prepare a properly formatted statement of protest in accordance with a suggested IRS procedure. This letter demanded receipt of the formal protest statement no later than October 23, 1982, three days after the letter was mailed from the IRS office.

19. Plaintiff prepared the Report of Interview and his formal statement of protest, and sent it to the Kentucky IRS office on November 3, 1982. He again asked for a hearing on the matter.

20. Plaintiff received no response to this request. Instead, he received a notice that the 100% penalty had been assessed on December 27, 1982.

21. Although the Internal Revenue Service later agreed to Plaintiff's attorney's request for a post-assessment appeals hearing, the IRS refused to suspend any collection efforts.

22. Plaintiff never willfully failed to account for or pay over any taxes owned by Ivey Energy Resources, Inc.

23. The Internal Revenue Service erroneously assessed the 100% penalty without giving Plaintiff a hearing or any meaningful opportunity to present the facts of his case.

Wherefore Plaintiff demands judgment against Defendant for the sum of $3,178.87; plus interest accruing from May 10, 1984, until the date of payment; costs; and attorney's fees under the Equal Access to Justice Act of 1980, 28 U.S.C. § 2412(d); and trial by jury.

Dated: September 19, 1984.

J. Carlton Howard, Jr.,
Attorney for Plaintiff.

David B. Smothers, Plaintiff v. United States of America, Defendant, in the United States District Court for the Eastern District of Virginia, Alexandria Division

CIVIL ACTION NO. 84-946-A

Answer

Now comes the defendant, United States of America, through its attorney, Elsie L. Munsell, and answers each paragraph of plaintiff's complaint as follows:

1. Admits.

2. Defendant is currently without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 2 of the complaint.

3. Defendant is currently without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 3 of the complaint.

4. Admits.

5. Admits.

6. Denies.

7. Defendant is currently without information or knowledge sufficient to form a belief as to the truth or veracity of the allegations contained in paragraph 7 of the complaint.

8–14. Denies.

15–21. Defendant is currently without information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 15–21 of the complaint.

22–23.

Wherefore, Defendant, United States of America, prays as follows:

1. That the complaint be dismissed with prejudice;
2. That all relief requested by plaintiff be denied; and
3. That the Court grant such other and further relief as this Court deems just and proper.

Elsie L. Munsell,
United States Attorney
Of Counsel:
J. Stephen Carlton,
Trial Attorney, Tax Division.

Certificate of service

It is hereby certified that service of the foregoing Answer has this 19th day of November, 1984, been served on opposing counsel, postage, addressed to the following:

J. CARLTON HOWARD, JR.
J. STEPHEN CARLTON.

DAVID B. SMOTHERS, PLAINTIFF, v. UNITED STATES OF AMERICA, DEFENDANT. IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA, ALEXANDRIA DIVISION

CIVIL ACTION NO. 84-946-A

ORDER

For the reasons stated from the bench, the court being of the opinion that the position of the United States in the civil proeedings in this court was not unreasonable, it is hereby

ORDERED that the motion of the plaintiff for an award of litigation costs pursuant to 26 U.S.C. § 7430(a) is denied.

——— ———,
United States District Judge.

Alexandria, Virginia, April 5, 1985.

DAVID B. SMOTHERS, PLAINTIFF, v. UNITED STATES OF AMERICA, DEFENDANT. IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA, ALEXANDRIA DIVISION

CIVIL ACTION NO. 84-946-A

Memorandum in support of motion for award of litigation costs under the authority of 26 U.S.C. § 7430

Section 7430 of the Internal Revenue Code (Code) allows for the award of reasonable litigation costs to the prevailing party in a tax refund suit. To qualify as a prevailing party one must substantially prevail on either the amount in controversy or the most significant issue. Further, the prevailing party must establish that the position of the United States in the civil proceeding was unreasonable. I.R.C. § 7430(c)(2)(A)

The parties have reached a settlement under which Plaintiff will receive a one hundred percent concession by the United States. Therefore, the first test of the definition of prevailing party has been satisfied.

The actions of the Internal Revenue Service and the Tax Division of the Department of Justice, in vigorously defending these actions, have been unreasonable in matters of both substance and procedure. Therefore, Plaintiff should be considered a prevailing party.

The issue in the refund suit is whether Plaintiff was a person required to collect, truthfully account for, and pay over the employment taxes of Ivey Energy Resources, Inc., a corporation doing business out of London, Kentucky. Were Plaintiff such a "responsible officer" of the company, a coal mining concern which began and closed business in 1981, he would have been liable for the 100 percent penalty described in section 6672 of the Code.

Although Plaintiff was nominally the secretary-treasurer of the company, the Government conceded this case because of overwhelming facts negating any willfulness of Plaintiff, a necessary element of the 100 percent penalty. Essentially, Plaintiff was a young "go for" in the company, and was strictly subject to the direction and control of Mr. Sid Mullins, the company president. These especially included payment and accounting for taxes.

The IRS never made findings of fact in support of its conclusion that Plaintiff was a "responsible officer," subject to section 6672 of the Code. Because of this, Plaintiff was never given a realistic administrative opportunity to demonstrate why the position of the IRS was incorrect. IRS proposed the assessment without saying why. Instead, it suggested that Plaintiff submit a written statement why he should not be considered a responsible officer. When Plaintiff did so, the IRS assessed the tax without considering Plaintiff's statement, or even acknowledging that it had received the statement.

On September 10, 1982, a Kentucky office of IRS sent a letter to Plaintiff at his former Abingdon, Virginia, address, proposing assessment of the 100% penalty. Plaintiff received the letter after it was forwarded to his Alexandria, Virginia address. Upon receipt of the letter, Plaintiff contacted the local IRS office at Bailey's Crossroads, gave them his new address, and asked what he should do to get the proposed tax changed. On September 23, 1982, Plaintiff received a properly addressed letter from IRS outlining his appeal rights and giving him thirty days to request a hearing.

The instructions in this letter stated that a written protest was not necessary unless more than $2,500.00 in tax assessments were proposed for any of the tax periods involved. Neither of the two quarters of employment taxes in issue in this case were for an amount as large as $2,500.00. Therefore, Plaintiff wrote to the IRS office in Corbin, Kentucky, and simply asked for an appeal.

On October 19, 1982, the Kentucky office wrote Plaintiff and requested that he send a Report of Interview, a lengthy form used by the IRS in making determinations about the applicability of the 100% penalty. The following day, the same IRS office again wrote to Plaintiff and demanded that the Report of Interview be received in Kentucky no later than October 23, 1982. This was three days from the date of the letter. On October 27, Plaintiff telephoned the Kentucky office to let them know he was still preparing the Report of Interview. He mailed the Report of Interview on November 3, 1982.

The next contact Plaintiff received from IRS was a Notice and Demand for Payment of Tax, dated December 27, 1982. The Service never acknowledged receiving the Report of Interview. No hearing was ever offered Plaintiff. Indeed, the 100% penalty had been assessed without Plaintiff ever being told the reasons why IRS considered him to have been a responsible officer.

On January 19, 1983, Plaintiff hired counsel to represent him in this matter. This attorney sent a letter to the Kentucky IRS office the following day, requesting a suspension of collection activities, the reopening of the case for purposes of an appeal, and the transfer of the case to the local IRS district. IRS responded with a letter dated February 7, refusing to suspend collection. A post-assessment appeal was granted, however, and the case was transferred to the Appeals Office, in Washington, D.C.

An Appeals conference took place on June 30, 1983. Appeals Officer Al Danon admitted at this conference that Plaintiff's statement had substantial merit with respect to the issue of willfulness. Mr. Danon demanded, however, that Plaintiff provide corroboration of his story. This was difficult to do because Plaintiff had no records of the corporation, no contact with any of the corporate officers, no addresses or telephone numbers, and no idea of where to find them. He did provide Mr. Danon with the name, address and telephone number of the CPA who prepared the first quarterly employment tax return in issue in this action. The accountant, Mr. Duke Moore, was able to provide partial corroboration of Plaintiff's statement.

Despite Plaintiff's statement to the Appeals Office and the partial corroboration provided through Mr. Moore, the Appeals Office determined that the 100% penalty would stand. Mr. Danon stated that he considered Plaintiff to be a "likable guy" who probably "got screwed by Mullins" (the president of the underlying corporation who was the true responsible officer). Mr. Danon further said, however, that without recourse to Mr. Mullins he could not let Plaintiff off. In other words, the IRS was going to exact payment from Plaintiff whether he was responsible or not, because the whereabouts of the actual responsible officer were unknown.

Plaintiff received the final adverse letter from Appeals on April 14, 1984. This letter stated that Plaintiff could expect a bill for the tax and accrued interest in the mail in the near future. Plaintiff never received the bill. Instead, he received a statement from his employer on May 3, 1984, that his wages had been levied by the Internal Revenue Service. The Service's action was harsh enough in unjustly denying Plaintiff his appeal. The added embarrassment of a levy on his wages, less than three weeks after he was told that a bill would be coming in the mail, is unconscionable.

Plaintiff paid the entire assessment on May 10, 1984, after getting a loan from his wife's credit union.

Despite this wretched administrative history, the Department of Justice chose to vigorously defend Plaintiff's refund suit. Defendant's Answer denied most of the allegations of the Complaint, including all of those with respect to procedural irregularities by IRS. Ten days after filing the Answer, Defendant's attorney submitted "Defendant's First Set of Interrogatories to the Plaintiff" and "United States" First

Request for Production of Documents". The interrogatories contained 20 questions. Eighteen of the twenty interrogatories had two to fourteen subparts.

In response to this formal discovery request, Plaintiff's counsel suggested a conference with Defendant's counsel at which all documentation in Plaintiff's possession would be provided and all questions of Defendant would be answered. The meeting took place and the information was given. In spite of this, Defendant's counsel demanded that Plaintiff give a formal written response to the interrogatories. Plaintiff did so, and then made himself available for a formal deposition. The answers to interrogatories and the deposition of Plaintiff were the third and fourth times he had given the Government the same information with respect to the issues in this case. Finally, the Government relented and agreed to concede the case in full.

The handling of this case by the Government at both the administrative and litigation stages could not more clearly fit within the scope and thrust of section 7430 of the Code. Although there are few cited cases under this relatively new statute, an instructive opinion is that of the Southern District of Florida in *Penner* v. *United States,* 84-2 USTC ¶9775(S.D.Fla. 1984). In that case a jeapordy assessment by the IRS had been found to be unreasonable by the court. In the proceeding under the motion for attorney's fees, the Justice Department's defense of unreasonable actions by the IRS was found to be of itself unreasonable. The court reasoned that, upon close scrutiny, the Justice Department could have determined the unreasonableness of the actions of the Internal Revenue Service before filing an answer in the civil case. Therefore, the court found that the taxpayer had met the qualifications of section 7430. See also, *Hallam* v. *Murphy,* 586 F.Supp. 1(N.D.Ga. 1983) (attorney's fees granted despite Government's concession of refund suit two months after it was filed).

The total amount in issue in this litigation was less than $3500.00. Plaintiff has been dealing with the Government for nearly 2½ years in his attempt to make it see the reason of his position. He has paid substantial counsel fees and costs, even before this federal action commenced. The attorney's fee statutes passed by Congress in recent years have been in response to situations, like this, where a small taxpayer faces substantial expenses to obtain relief from arbitrary and unreasonable Government actions. Frankly, without the knowledge that section 7430 of the Code exists, Plaintiff would not have been able to justify the cost of pursuing his rights in the face of the shameful acts of the IRS in his case. Therefore, Plaintiff prays that this Court grant his motion for the award of litigation costs, pursuant to the authority of 26 U.S.C. §7430.

Respectfully submitted,

J. CARLTON HOWARD, JR.,
Attorney for Plaintiff.

CERTIFICATE OF MAILING

I hereby certify that on the 28th day of February, 1985, a true copy of the foregoing Memorandum in Support of Motion for Award of Litigation Costs Under the Authority of 26 U.S.C. §7430 was mailed, postage prepaid, to Mr. Stephen Carlton, Trial Attorney, Tax Division of the Justice Department, Washington, D.C. 20530.

J. CARLTON HOWARD, JR.

STATEMENT OF J.H. MCQUISTON, MCQUISTON ASSOCIATES, LOS ANGELES, CA

Mr. Chairman and Members of the Committee: McQuiston Associates is a "think tank" which, since the enactment of P.L. 96-481 (EAJA), has been extensively analyzing fee-award cases per EAJA and Sec. 7430, and others as well, in order to (1) form an opinion regarding their effectiveness, and (2) clarify the statutes. In the process McQuiston not only collects data but also serves as advisor and litigator in major cases.

This Statement is particularly apropos here, because it was witness Sterrett who adjudicated *McQuistion* v. *CIR,* 78 TC 807 (1982), which announced the intention of the Tax Court not to make fee awards under any circumstances.

H.R. 829 proposes to repeal 28 U.S.C. 7430(f). Repeal will make permanent Section 292 of P.L. 97-248 (TEFRA).

It is my conclusion after four years of intensive analysis that it would be terribly unwise and extremely embarrassing for this Committee to extend Sec. 292 without repealing Sec. 292(c). But replacing Sec. 292 with EAJA alone would not only be more cost-effective for the United States but also *less cruel* for litigants which might be fooled into believing awards are possible under Sec. 292 as presently worded.

Sec. 292(c) invaded the domain of the Judiciary Committees and destroyed a universal safety-net which those Committees had painstakingly crafted. And those Committees were not given any notice of Sec. 292 until it was enacted in a procedure prohibiting amendment thereof. Consequently, the expertise of prior history was sacrificed to the hysteria and panic of the moment. Sec. 292 thus added to a "patchwork" that the Judiciary has formally condemned, and defeated the effort of the Judiciary Committees to bring some uniformity to fee awards.

I believe it was a serious mistake for this Committee to ignore the work of the Judiciary Committees, especially because Sec. 292 is very poorly-drafted in comparison to other statues regulating judicial procedure. The legal complexities and respondent superior issues demand a more elegant approach.

I support the right of this Committee to be more liberal than the general-purpose safety net in EAJA. And I support the right of this Committee to ask for revisions by the Judiciary Committees. But if this Committee decides that it has a right to march through the United States Code and make revisions at will, and within legislation intended for another purpose altogether, then the die is being cast for other committees to do likewise, and our system of laws will just disappear into chaos.

I know this Committee believed its situation was unique with respect to fee awards. But so did many other committees' agencies. Nonetheless, they all have prospered under the Judiciary Committees' statutes.

The Judicial Conference repeatedly has said that "amendments to the 'American Rule' should not be piecemeal". And the Judiciary has perversely made its point by retaliating in fee-award situations. This retaliation is injuring innocent third parties. Only with a uniform statute, applied equally to all agencies, will the equitable relief so desired by Congress and by the citizenry be achieved.

Executive doomsayers who stampeded this Committee into enacting Sec. 292 by force have now been exposed as clearly false prophets. After all the hand-wringing, there has been only $47,726 paid on account of Treasury actions under EAJA, in three years. Surely that amount has not broken the floodgates of the public fisc. And the further irony is the fact that courts have now "borrowed" for Sec. 292 the very award standard in EAJA that was advertised to this Committee as horrific, and which was cited as the urgent need for another standard and Sec. 292. See, e.g., *Kaufman* v. *Egger*, 1 Cir No. 84-1641 (Mar. 19, 1985); *Baker* v. *CIR*, 83 TC ——— (Nov. 28, 1984). *Nothing* was gained by enacting Sec. 292.

In sharp contrast to the minuscule fees paid under EAJA, DOJ now budgets $100 million for "victim grants" in FY 1985 & 1986. One wonders how "victimized" litigants must become, to be eligible for a little fee-award compassion for DOJ.

The precise language adopted in Sec. 292 has cleverly made free awards theoretically impossible thereunder. And courts are required to give effect to every word in Sec. 292. See, e.g., *Reiter* v. *Sonotone Corp*, 442 U.S. 330, 339 (1979). Statutes must be interpreted strictly in favor of the United States where a payment from the public treasury is involved. See *McMahon* v. *U.S.*, 342 UY.S. 25, 27 (1951). Courts which have allowed the few awards under Sec. 292 simply have *not* followed the above rules. And we must question the professionalism of DOJ employees allowing such awards.

28 U.S.C. 7430 begins innocuously, but in its special definition of "prevail" it becomes clear that no one is supposed to receive anything. The clear language will prevent anyone from qualifying.

To "prevail", the victory cannot be caused by the act of anyone but the United States. Inasmuch as no agent is the United States (an unreasonable agent loses its right of agency), per se all awards are barred. Certainly there can be no respondeat superior if an agent acts unreasonably. See, e.g, *Doe* v *D.C*, 697 F2d 1115, 1121 (DC Cir 1983) (no respondeat superior); *Krejci* v *U.S. Army*, 733 F2d 1278, 1282 (7 Cir 1984) (no liability for deceit); *Feres* v *U.S*, 340 U.S. 135 (1950) (no liability for gross negligence); *City of Newport* v *Fact Concerts*, 453 U.S. 247, 263 (1981) (taxpayers not responsible for agent's improper action); *Bivens* v *Unknown Agents*, 403 U.S. 388 (1971) (cause of action not against U.S. but against agent for unreasonable act).

Moreover, the standard specifically requires the "position of the United States" to be "unreasonable". This language again bars all awards, because it is axiomatic that the United States is never unreasonable. The United States acts by a law, which is defined as reasonable behavior. If an agent acts unlawfully, the agent does not act in the way that the United States prescribed. Moreover, no constitutional clause authorizes payment from the treasury for such damages. Thus Sec 292 cannot be constitutional, if the statute so authorizes. See, e.g, J-98-40 (98th Senate Judiciary Committee).

Reviewing *Kaufman*, we see a fatal mistake in the court's logic. That court failed to determine "prevail" properly. In fact, even under the EAJA standard it substituted, the court misapplied the Circuit's "prevail" standard, set forth in *Nadeau* v *Helgemoe,* 581 F2d 275 (1 Cir 1978). The agency having clearly acted "gratuitously", Kaufman did not even prevail under the regular standard. But *Kaufman* proves the necessity for one uniform standard for courts to learn.

Sec 292 of course could be revised to make awards possible. "Unreasonable" and "United States" could be dropped in favor of more suitable terms. But in the end, what would be gained but another patchwork? And why do we need that?

After *McQuiston* v *CIR,* the Tax Court clearly will not make EAJA awards until special legislation is enacted. But a better approach than Sec 292 would be to establish by statute that 5 U.S.C. 504 is applicable to all Treasury matters conducted in Art I forums. This Committee may do that.

Moreover, the term "substantially prevailed" in Sec 292 inherently will block Tax Court awards, because of the limitations on Tax Court decisions. The Tax Court only determines the amount of a deficiency, or that there is not deficiency, but will not determine the amount of credit if there is no deficiency. See, e.g, *CIR* v *Gooch Milling,* 320 U.S. 418 (1943). Sec 292 will not work if, say, the controversy concerns whether the taxpayer owes $100 or the agency owes $1,000.

A further problem with Sec 292 is found in the Committee Reports H. Rep 97-404 at 12, and Senate Report in Dec 16, 1981 Record at S 15594, state that no award should be made if the agency litigates to establish a conflicting case to serve its own ends. On its face, this language admits that an opposing party serves a "public" purpose by merely agreeing to litigate with the agency, and if so then equity requires a fee award under the American Rule. See, e.g, *Ex Parte Plitt,* 2 Wall Jr 453 (3 Cir 1853) (followed in *Trustees* v *Greenough,* 105 U.S. 527 (1881) and implicit in *Alyeska* v *Wilderness Society,* 421 U.S. 240 (1975)). The Reports show it is perilous for another committee to intrude within the quagmire supervised by the Judiciary Committees without deference to them.

Those Reports evidenced the desire to liberalize the safety net of EAJA for some parties. But that can be done without removing the net altogether. I would support allowing more parties to use the safety net, because the law is then more uniform and the courts want it thus. But if one compares EAJA statistics for Art I and Art III forums, one deduces that the Art I forums are biased in favor of their "boss", the Executive. The Tax Court similarly will feel the pressure not to award. Thus, expanding its eligibility-jurisdiction will accomplish very little.

And I seriously doubt that affluent litigants will even consider applying for such awards, which presently cost more to obtain than they are worth.

These last issues present a serious problem for the Nation, and the Committee would be well-advised to help the Judiciary Committees solve it quickly. Thereafter is time enough to reinstate Sec 292, if indeed it will be required at all. But first and foremost the Committee should repeal Sec 292(c) as quickly as possible.

Thank you for the opportunity to present this Statement.

MOHLE, THOMAS & MARSHALL ACCOUNTANCY CORP.,
Chico, CA, April 29, 1985.

Mr. JOSEPH K. DOWLEY,
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, DC.

DEAR MR. DOWLEY: Internal Revenue Code Section 7430 provides for the reimbursement of attorneys fees when the taxpayer has prevailed in a court proceeding against the United States. The provisions of this section should be retained. Additionally, they should be expanded.

The Internal Revenue Service processes millions of forms, letters and documents each year. Most of this information is processed correctly and without contact with the taxpayer. Often, in what seems an increasing number of cases, they process the information incorrectly. When the information is improperly processed, the Internal Revenue Service either bills the taxpayer for additional tax, or sends them an erroneous refund. Examples of common errors are:

The Internal Revenue Service's Fresno Service Center often fails to credit the deposit of employment taxes to the proper tax period. They issue a deficiency notice for the amount of alleged underpaid tax for one period, and issue a notice of overpayment for the subsequent period in the same amount. Even after the taxpayer furnishes adequate evidence to allow the government to correct the error, several follow up letters are required to force the Internal Revenue Service to correct its error.

Fresno Service Center, at this time, is rejecting correctly completed Forms 1045, Applications for Tentative Refund (Internal Revenue Code Section 6411). Taxpayers expend time and money explaining to the Internal Revenue Service why the Internal Revenue Service is wrong.

My proposal is to add a provision to the Internal Revenue Code that requires the United States to reimburse the taxpayer for the cost of rectifying an Internal Revenue Service error. This type of provision would help eliminate the feeling that the present tax administration system (not tax system) is unfair.

My specific proposal is that a reimbursement to taxpayers in the greater amount of; $100, or 2% the amount of tax or payment incorrectly billed, refunded, or collected be provided for in the Internal Revenue Code. This reimbursement would be applicable when the Internal Revenue incorrectly processes a return, form or document that is correctly filed by the taxpayer. Additionally, it would apply to notices issued in connection with the information document matching program (CP 2000), including Notices of Deficiency.

The Internal Revenue Code must provide for reimbursement of taxpayers' costs in situations where the United States is clearly wrong. Reimbursement insures that Internal Revenue Service employees are held more accountable for their actions, reduces the feelings that many taxpayers have that they are being treated unfairly by the government, and will provide Congress with information about the Internal Revenue Service's ability to correctly process the information required by a complex tax code.

Very truly yours,

JOHN F. MCKENNA, Jr.,
CPA.

VALENSI, ROSE & MAGARAM,
Los Angeles, CA, May 15, 1985.

CHIEF COUNSEL,
Ways and Means Committee, House of Representatives, Washington, DC.

DEAR SIR: Section 7430 of the Internal Revenue Code provides that, under certain limited circumstances, a taxpayer is entitled to recover his legal fees and costs from the government in a tax-related lawsuit. Pursuant to the terms of that section of the Code, legal fees will not be awarded for cases filed after December 31, 1985. Congress is currently considering extending the applicability of said section beyond the end of 1985.

The cases have gone both ways as to whether or not Congress intended to include the award of legal fees incurren prior to the lawsuit stage of the case. Obviously, for future applicability of the statute, the statute itself can answer that question. I would like to give you my thoughts on that matter, as well as other aspects of that Code secton.

Let me first state that I am a practicing tax attorney in Los Angeles. I was a trial attorney for the Office of Regional Counsel, Internal Revenue Service, in Los Angeles, from 1970 through 1975. I have been in private practice since then. I am constantly in touch with the Internal Revenue Service on all levels, and I set up and unilaterally run on behalf of the Los Angeles County, Beverly Hills and Century City Bar Associations a pro bono program which represents petitioners in the United States Tax Court who have no legal representation but for our program.

For a number of reasons, which are very common in dealing with a large monolith such as the Internal Revenue Service, personnel for the Internal Revenue Service often take unreasonable positions during all stages of audit and appeal prior to the lawsuit stage. Taxpayers are often put through a "living hell" emotionally, financially and from a time spent point of view.

From a fairness point of view, something should be done to prevent the Internal Revenue Service from taking unreasonable positions at any level of the Internal Revenue Service. Unfortunately, the awarding of attorneys' fees against the Internal Revenue Service will not accomplish this result. As a famous author once said: "A monolith is a monolith is a monolith." The awarding of legal fees at the administrative stage will not change this fact. The passage of legislation awarding legal fees at the administrative stage could cause the Internal Revenue Service to dramatically change its policies. This would hamper the deficiency determination process and collection process of the Internal Revenue Service, and could severely cut back the overall effectiveness of the Internal Revenue Service and the so-called "self-assessment" system. The personnel of the Internal Revenue Service already have enough monkeys on their back that prevents them from trying to perform as well as they can under the circumstances.

On the other hand, if the Internal Revenue Service has taken an unreasonable position that has forced a taxpayer to file a lawsuit, it is my opinion that all of the legal fees and costs incurred by a taxpayer under such circumstances in filing a lawsuit, and thereafter, should be paid by the Internal Revenue Service if the provisions of § 7430 are applicable. For example, a large percenage of cases brought in the United States Tax Court have been brought after the legal baranch of the Internal Revenue Service has reviewed the statutory notice of deficiency. Maybe the test should be whether or not a legal branch of the Internal Revenue Service or the Justice Department has reviewed any documents with respect to the case prior to the filing of the lawsuit. I personally feel, however, that, if the Internal Revenue Service has been unreasonable within the parameters of § 7430, they should be required to pay all legal fees incurred with respect to the filing of the lawsuit. At some stage, the Internal Revenue Service must be held accountable.

Another possible test for whether or not the legal fees expended by the taxpayer should be recouped by the government is whether the government files a responsive pleading to the taxpayer's lawsuit which is other than a concession of the case. While this places a very difficult burden in the attorney for the government, again, how long should the government be able to hide behind its arbitrariness.

Finally, it is my opinion that the Internal Revenue Code should be amended to (1) increase the "delay" penalty against taxpayers from a maximum of $5,000 to $10,000, and (2) broaden the standards under which the penalty should be awarded to the government. While this may cause certain taxpayer groups to scream, tax practitioners like myself realize that the tax system will function more for the benefit of all taxpayers if these surreptitious taxpayers can be weeded out more efficiently.

Please do not hesitate to contract me if you wish to have someone from the legal staff talk to me further about this matter. I would be happy to testify at any committee hearings if you desire that I do so.

Sincerely,

Jonathan A. Brod.

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